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**Environmental Cleanup under Public Law 85-804:  
Keeping the Ordinary out of Extraordinary Contractual Relief**

By  
Patrick Edward Tolan, Jr.  
B.S.E.E., May 1984, United States Air Force Academy  
J.D., May 1990, University of Michigan

A Thesis submitted to  
The Faculty of

The George Washington University  
Law School  
In partial satisfaction of the requirements  
for the degree of Master of Laws

August 31, 2002

Thesis Directed by  
Steven L. Schooner  
Associate Professor of Government Contracts Law

Arnold W. Reitze, Jr.  
Professor of Environmental Law

**Fighting Goliath with Both Hands Tied behind Your Back:  
Public Law 85-804 and the Environmental Liability Conundrum**

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## I. Introduction

In the wake of the events of September 11, 2001, President Bush pledged, “Whatever it costs to defend our country, we will pay it.”<sup>1</sup> Not since the bombing of Pearl Harbor, has America been so shocked and surprised by the hostile acts of others.<sup>2</sup> Then, as now, emergency spending to mobilize the industrial base and apply America’s industrial strength to the war effort were seen as the key to victory.<sup>3</sup> When American soil is attacked, the urgency of fueling the American war machine becomes paramount.

Congress passed the First War Powers Act just eleven days after the Japanese bombed Pearl Harbor.<sup>4</sup> The Act gave the President broad powers in times of war to circumvent nearly all of the constraints of government contracting.<sup>5</sup> It “provided a

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<sup>1</sup> *Excerpts: 9/11 ‘brought out the best’ of USA*, [Excerpts from President Bush’s State of the Union Address, Jan. 29, 2002], USA TODAY, Jan. 30, 2002, at A6 [hereinafter State of the Union].

<sup>2</sup> “The President’s speechwriters steeped themselves in earlier State of the Union messages, but none apparently was as resonant as FDR’s message in 1942, delivered less than a month after the attack on Pearl Harbor.” David M. Shribman, *State of the Nation Address/News Analysis: For a Leader Transformed, Struggles Lie Ahead for this Leader, Struggles Lie Ahead*, THE BOSTON GLOBE, Jan. 30, 2002, at A1. Roosevelt spoke of suicide attacks and a fight to “cleanse the world of ancient evils” saying, “I am proud to say to you that the spirit of the American people was never higher than it is today—the Union was never more closely knit together—this country never more deeply determined to face the solemn tasks before it.” *Id.*

<sup>3</sup> President Roosevelt referred to the WWII build up of U.S. industry as the “Arsenal of Democracy.” JAMES F. NAGEL, A HISTORY OF GOVERNMENT CONTRACTING 404 (1992). In addition to the immediate authorization of \$40B, President Bush asked for the highest defense spending increase in twenty years. State of the Union, *supra* note 1.

<sup>4</sup> First War Powers Act, 1941, 55 Stat. 838, 839 (1942) (codified at 50 U.S.C. App. § 611 (repealed 1966)).

<sup>5</sup> *Id.* at § 201 (President may authorize any department or agency, in connection with the prosecution of the war effort, to enter into contracts, amendments or modifications of

Continued Next Page



virtually complete emancipation from peacetime procedural limitations on contracting.”<sup>6</sup> Congress renewed these extraordinary contractual powers during the Korean War and ultimately passed Public Law 85-804 [hereinafter also referred to as 85-804] as permanent legislation.<sup>7</sup> 85-804 continues to allow extraordinary relief to government contractors to facilitate the national defense.

Many contractors face liability for waste generated (in whole or substantial part) while performing government contracts. Nationwide cleanup for past environmental sins is expected to cost hundreds of billions of dollars.<sup>8</sup> Therefore, it is no surprise that government contractors have sought 85-804 relief for environmental liabilities.

In the mid-1990’s, once such contractor received more than \$6.5 million in extraordinary relief due to contamination at its weapon manufacturing facility.<sup>9</sup> At that time,

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contracts and to make advance payments without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts).

<sup>6</sup> See Randall J. Bunn, *Contractor Recovery for Current Environmental Cleanup Costs Under World War II-Era Government Contract Indemnification Clauses*, 41 A.F. L. REV. 163, 179 (1997). The article provides an excellent historic perspective on indemnification clauses in general and World War II clauses in particular. For similar analysis of Vietnam-Era indemnification clauses, see Kenneth M. Theurer, *Sharing the Burden: Allocating the Risk of CERCLA Cleanup Costs*, 50 A.F. L. REV. 65 (2001).

<sup>7</sup> Pub. L. No. 85-804, 72 Stat. 972 (1958) (codified as amended at 50 U.S.C. §§ 1431-1435 (2002)). Details concerning the history of Public Law 85-804 are provided *infra*, at Section III.B.

<sup>8</sup> “[E]stimates indicate that cleanups are expected to cost the federal government about \$300 billion and the private sector hundreds of billions more.” SUPERFUND: PROGRESS MADE BY EPA AND OTHER FEDERAL AGENCIES TO RESOLVE PROGRAM MANAGEMENT ISSUES, GAO/RCED-99-111, Apr. 1999.

<sup>9</sup> Nuclear Metals, Inc., ACAB No. 1244, 4 ECR Reporter ¶ 83, Sept. 13, 1996, as amended in, Nuclear Metals, Inc., ACAB No. 1244A, 4 ECR Reporter ¶ 86, Mar. 5, 1997. (Nuclear Metals, Inc. later changed its name to Starmet).

environmental liability threatened the very existence of this critical defense contractor.<sup>10</sup>

Less than five years later, a similar request for relief was denied when this contractor was no longer deemed essential.<sup>11</sup> The contractor now teeters on the brink of bankruptcy.<sup>12</sup> This case illustrates the fickle nature of environmental relief under Public Law 85-804.<sup>13</sup>

## II. Overview

This thesis analyzes how Public Law 85-804 relates to environmental cleanup costs and toxic tort liability. I argue that extraordinary relief should be reserved for *extraordinary* circumstances. While 85-804 preserves an umbrella of protection for catastrophic situations, the government ought not indemnify contractors for *ordinary* environmental liability. I define “ordinary” liability to include costs of environmental compliance and costs arising from corrective or remedial actions to clean up leaching landfills or similar releases resulting from waste disposal. Ordinary releases are not sudden, not unusual, and not unexpected. Congress did not intend 85-804 to shelter these ordinary releases. Likewise, costs for toxic tort liability stemming from such contamination are ordinary environmental costs.

Conversely, catastrophic accidental releases of toxic substances, which qualify as “unusually hazardous risks,” are more properly covered by 85-804. I advocate that Congress legislate to uniformly indemnify contractors for nuclear risks and clearly define “unusually

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<sup>10</sup> *Id.*

<sup>11</sup> *Starmet*, ACAB No. 1248, 4 ECR Reporter ¶ 92, Dec. 4, 2000 (rejecting extraordinary relief request to recover environmental remediation costs exceeding \$17 million).

<sup>12</sup> *Starmet*’s stock price has tumbled from \$35 per share to less than one-half cent per share. Stock prices checked via the Internet, corporate symbol “STMT” (visited May 15, 2002) <<http://www.CBS.marketwatch.com.html>>.

<sup>13</sup> The *Starmet* case is discussed at length below. See notes 362-374 and accompanying text in section VI.B, *infra*.

hazardous risks” to eliminate inconsistencies among agencies. Finally, I call for clarification regarding when extraordinary contractual relief facilitates the national defense.

This thesis begins by examining the background of Public Law 85-804. The executive orders and acquisition regulations implementing 85-804 are also explained. This background is essential for analyzing the nature and scope of extraordinary relief available. The historical context also provides a foundation for understanding 85-804’s limited purpose.

Next, I analyze environmental liability with a focus on difficulties confronting contractors attempting to recover from the government under CERCLA.<sup>14</sup> Facing retroactive laws imposing strict liability, even a prudent contractor following today’s best practices could find itself liable down the road if those practices prove unsuccessful to protect the environment.<sup>15</sup> This section also explores how it has been almost impossible to find the government liable for toxic torts based upon past waste disposal practices. Difficulties with environmental or tort recoveries drive contractors to explore contractual remedies.

Section IV evaluates other potential methods a contractor could use to recover environmental costs. I consider cost-type contracts, indemnification pursuant to § 119 of the Superfund Amendments and Reauthorization Act (SARA),<sup>16</sup> and other statutory

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<sup>14</sup> Comprehensive Environmental Response, Compensation, and Liability Act of 1980 [hereinafter CERCLA] (codified as amended at 42 U.S.C. §§ 9601-9675 (2002)). CERCLA § 113(f) allows courts to equitably allocate response costs among potentially responsible parties (PRPs). 42 U.S.C. § 9613(f) (2002).

<sup>15</sup> One company characterized cleanup contracts as “bet the company” propositions due to the prospect of massive unknown future liability. *Contractors Urge DoD to Limit Liability on Cleanup Contracts*, BNA FED CONT. DAILY, Mar. 17, 1992.

<sup>16</sup> Superfund Amendments and Reauthorization Act [hereinafter SARA], Pub. L. No. 99-499, 100 Stat. 1697 (1986) (codified as amended at scattered sections of 42 U.S.C. §§ 9601-9675 (2002)).

indemnification authorities.<sup>17</sup> This section also explores standard government contract clauses that could provide an avenue for reimbursement based upon the contract. These approaches all suffer certain limitations or disadvantages, which are explained in the thesis.

The following section examines the advantages of Public Law 85-804 compared to other indemnification or contractual relief. 85-804 clauses survive contract completion. They also permit recovery of legal expenses and avoid Anti-Deficiency Act constraints. It is easy to see why contractors find Public Law 85-804 indemnity so attractive.

However, there are numerous limitations and difficulties for contractors seeking 85-804 indemnification. These limitations are evaluated in Section VI. Indemnity is limited to risks identified as unusually hazardous in the contract. The government has unfettered discretion to approve (or deny) an 85-804 indemnity clause. Furthermore, the agencies authorized to use this authority differ in their practices regarding environmental liability. This thesis explores the disparate use of 85-804 by the Army, the Navy, the Air Force, and other federal agencies and recommends legislative changes to improve uniformity.

Where government contracts lacked indemnification clauses, contractors have recovered environmental cleanup costs by application to government contract adjustment boards (CABs) for "Extraordinary Contractual Relief" (ECR)."<sup>18</sup> The final section addresses this aspect of Public Law 85-804. All four cases are discussed where contractors have been granted or denied ECR related to environmental liability. Based upon constraints imposed by

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<sup>17</sup> 10 U.S.C § 2354 (2002) (research and development indemnification); 42 U.S.C. § 2210 (2002) (Price-Anderson indemnification for nuclear incidents).

<sup>18</sup> Starmet, *supra* notes 9 and 11. See also Avtex Fibers Front Royal, Inc., AFCAB No. 262, 4 ECR Reporter ¶ 47, Dec. 18, 1988, and National Defense Corp., ACAB No. 1231, 4 ECR Reporter ¶ 47, Mar. 25, 1988.

the Federal Acquisition Regulation [hereinafter FAR], some defense contractors are denied ECR when such relief could facilitate the national defense. I recommend changes to the FAR to expand ECR to preserve second sources of vital military products and in other circumstances when relief benefits long-term national security.

### **III. Background**

Public Law 85-804 allows the United States to indemnify its contractors against “unusually hazardous or nuclear risks” when the President considers that such action would facilitate the national defense.<sup>19</sup> By Executive Order, the President delegated this authority to numerous federal agencies.<sup>20</sup> The Federal Acquisition Regulation implements this statutory authority at Part 50, “Extraordinary Contractual Actions.”<sup>21</sup> When approved, contracting officers include an indemnification clause in the contract, which defines these unusually hazardous or nuclear risks.<sup>22</sup> These 85-804 clauses have been used in hundreds of inherently risky government contracts when commercial insurance was inadequate.<sup>23</sup>

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<sup>19</sup> Pub. L. No. 85-804, 72 Stat. 972 (1958) (codified as amended at 50 U.S.C. §§ 1431-35 (2002)), as implemented by Exec. Order No. 11610, 36 Fed. Reg. 13,755 (1971) *reprinted as amended in* 50 U.S.C. § 1431 (2002).

<sup>20</sup> Exec. Order No. 10789, 23 Fed. Reg. 8,897 (1958), *reprinted as amended in* 50 U.S.C. § 1431 (2002).

<sup>21</sup> Fed. Acquisition Reg. [hereinafter FAR] 50.000-50.403. 48 C.F.R. §§ 50.000-50.403 (2002).

<sup>22</sup> FAR 50.403-3.

<sup>23</sup> According to the Extraordinary Contractual Relief Reporter, 85-804 indemnification clauses were included in 536 contracts awarded between 1980 and 1989. David V. Anthony and Carl L. Vacketta, Background and Explanation, Extraordinary Contractual Relief Reporter [hereinafter ECR Reporter], Note 130, ECR Reporter Current Materials, p.1015 (Fed. Pubs. Inc., 1991).

## A. Public Law 85-804

Congress passed Public Law 85-804 on August 28, 1958, after seven years of temporary authorizations for such relief during the Korean War.<sup>24</sup> Congress provided:

*[T]he President may authorize any department or agency of the Government which exercises functions in connection with the national defense, acting in accordance with regulations prescribed by the President for the protection of the Government, to enter into contracts or into amendments or modifications of contracts heretofore or hereafter made and to make advance payments thereon, without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts, whenever he deems that such action would facilitate the national defense. . . .*<sup>25</sup>

### 1. History and Purpose

The most notable aspects of Public Law 85-804 are the President's virtually carte blanche authority to authorize departures from government contract law and the stated purpose of facilitating the national defense.<sup>26</sup> Like its predecessor, Congress designed Public Law 85-804 to allow the President a temporary wartime shortcut around the government procurement system.<sup>27</sup> As originally passed, 85-804 authority was expressly

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<sup>24</sup> Pub. L. No. 85-804, *supra* note 19. See also An Act to Amend and Extend Title II of the First War Powers Act, 1941, Pub. L. No. 81-921, 50 U.S.C.A. App. § 611 note and Exec. Order No. 10120, 16 Fed. Reg. 1,049 (1951).

<sup>25</sup> *Id.* (emphasis added).

<sup>26</sup> The statute prohibits certain practices to limit potential abuses or inefficiencies associated with cost-reimbursement type contracts (where the government bears the predominant risk of cost overruns). Pub. L. No. 85-804, *supra* note 19, at Section 2. The basic authority has remained unchanged for over 40 years. 50 U.S.C. §§ 1431-1432 (2002).

<sup>27</sup> First War Powers Act, 1941, *supra* note 4, at Section 201 (limiting authority to facilitate "prosecution of the war").

limited to emergency wartime contracting.<sup>28</sup> However, in 1978, when the state of national emergency was terminated, Congress exempted Public Law 85-804 from the provisions of the Act terminating the emergency.<sup>29</sup> Effectively, until Congress or the President says otherwise, the “wartime” limitation has been read out of the statute (though the need to exercise these powers in support of the national defense remains).<sup>30</sup>

Because of the broad delegation of spending power to the executive branch, Congress included a mechanism for public reporting.<sup>31</sup> Most public notice requirements remained until relatively recently when they were repealed by the Federal Reports Elimination Act of 1998.<sup>32</sup> However, Congress continues to be notified and enjoys a type of “veto” authority in any action approving extraordinary contractual relief above \$25

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<sup>28</sup> “This Act shall be effective only during a national emergency declared by Congress or the President and for six months after the termination thereof or until such earlier time as Congress, by concurrent resolution, may designate.” Pub. L. No. 85-804, *supra* note 19, at Section 5.

<sup>29</sup> National Emergencies Act, Pub. L. No. 94-412, 90 Stat. 1255, 1258 (1976) (codified at 50 U.S.C. § 1651(a)(6) (2002)). A study was to be made of the exempted statutes, but it was never conducted. 50 U.S.C. § 1651(b) (2002). *See also* RALPH C. NASH, JR. & JOHN CIBINIC, JR., *FEDERAL PROCUREMENT LAW VOL. II* 2244-45 (3d Ed. 1980).

<sup>30</sup> Executive orders implementing Pub. L. No. 85-804 were similarly modified. Exec. Order No. 10789 was prefaced, “in view of the existing national emergency declared by Proclamation No. 2914 of December 16, 1950.” Exec. Order No. 10789, 23 Fed. Reg. 8,897 (1958). This language was deleted by Exec. Order No. 12919, of June 3, 1994. A legislative proposal was defeated in 1995 to forever delete the wartime or national emergency requirement. *See Proposed § 1207 of the National Defense Authorization Act For Fiscal Year 1996*, 141 Cong. Rec. S. 5805 at 5829-30 (Apr. 27, 1995).

<sup>31</sup> “All actions under the authority of this Act shall be made a matter of public record under regulations prescribed by the President and when deemed by him not to be detrimental to the national security.” Pub. L. No. 85-804, *supra* note 19, at Section 3(a). Section 4(b) required all these reports to be published in the Congressional Record.

<sup>32</sup> Pub. L. No. 105-362, 112 Stat. 3280 (1998) (striking 50 U.S.C. § 1434).

million.<sup>33</sup> The United States becomes obligated only if Congress fails to disapprove the relief within 60 days.<sup>34</sup>

## **2. Implementation**

Public Law 85-804 does not directly authorize agencies to use its provisions; rather, the President has discretion to empower agencies to exercise 85-804 authority.<sup>35</sup> The President's actions, and the actions of agencies to which he delegates power, are not subject to review by courts and no rights are conferred on contractors.<sup>36</sup>

### **a) Executive Orders**

President Eisenhower signed Executive Order 10789 on November 14, 1958, to implement Public Law 85-804.<sup>37</sup> This executive order was the eighth in a series of executive orders issued during the Korean War.<sup>38</sup> The first, signed by President Truman on Feb 2,

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<sup>33</sup> In 1973, Congress added a requirement to Public Law 85-804 that the Senate and House Armed Services Committees be so notified. Pub. L. No. 93-155, Title VIII, § 807(a), 87 Stat. 605, 615 (1973) (codified at 42 U.S.C. § 1431 (2002)).

<sup>34</sup> *Id.*

<sup>35</sup> This requirement parallels that of the First War Powers Act, 1941, which President Roosevelt was quick to utilize, signing Executive Order 9001 just nine days after the Act was passed. Bunn, *supra* note 6, at 178 n.95, citing NAGEL, *supra* note 3, at 427.

<sup>36</sup> *Bolinders Co. v United States*, 139 Ct. Cl. 677 (1957), *cert. denied*, 355 U.S. 953 (1958).

<sup>37</sup> Exec. Order No. 10789, *supra* note 20.

<sup>38</sup> Exec. Order No. 10120, 16 Fed. Reg. 1,049 (1951). Exec. Order No. 10216, 16 Fed. Reg. 1,815 (1951). Exec. Order No. 10227, 16 Fed. Reg. 2,675 (1951). Exec. Order No. 10231, 16 Fed. Reg. 3,025 (1951). Exec. Order No. 10243, 16 Fed. Reg. 4,419 (1951). Exec. Order No. 10281, 16 Fed. Reg. 8,789 (1951). Exec. Order No. 10298, 16 Fed. Reg. 11,135 (1951). Exec. Order No. 10789, 23 Fed. Reg. 8,897 (1958).



1951, authorized the Secretaries of the Army, Navy, Air Force, and Defense to use Public Law 85-804 contracting authority.<sup>39</sup> It provided:

The Department of Defense is authorized, within the limits of the amounts appropriated and the contract authorization provided therefore, to enter into contracts and into amendments or modifications of contracts heretofore or hereafter made, and to make advance payments thereon, without regard to the provisions of law relating to the making, performance, amendment, or modification of contracts, whenever . . . the national defense will be facilitated thereby.

It also added the first civilian agency, the Department of Commerce, to the list of agencies authorized to use this extraordinary power.<sup>40</sup> Subsequent executive orders added additional federal agencies. After the terrorist attacks of September 11, 2001, President Bush added the Department of Health and Human Services to those agencies authorized to exercise 85-804 authority, bringing the total number of authorized civilian agencies to twelve.<sup>41</sup>

The executive orders add legal restraints to the statutory limits noted above.<sup>42</sup> Executive Order 10789 was the first to expressly allow delegation of approval authority below the Secretarial level. While delegation was allowed, it prohibited obligating “the

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<sup>39</sup> Exec. Order No. 10120, 16 Fed. Reg. 1,049 (1951).

<sup>40</sup> *Id.*

<sup>41</sup> The following civilian agencies currently have Pub. L. 85-804 authority: Atomic Energy Commission; Department of Agriculture; Department of Commerce; Department of Health and Human Services; Department of the Interior; Department of Transportation; Department of the Treasury; The Federal Emergency Management Agency; General Services Administration; Government Printing Office; National Aeronautics and Space Administration [hereinafter NASA]; and Tennessee Valley Authority. Exec. Order No. 13232 of Oct. 20, 2001, 66 Fed. Reg. 53,941 (2001).

<sup>42</sup> There can be no discrimination on the basis of race, religion, color, or national origin, and all contracts must contain a nondiscrimination clause; the contractor must warrant that no person or agency was paid a contingency fee to secure the contract; advance payments shall be made only upon obtaining adequate security; and, the contractor must adhere to listed federal labor mandates. Exec. Order No. 10789, *supra* note 20.

United States in an amount in excess of \$50,000 without approval by an official at or above the level of an Assistant Secretary or his Deputy, or by a departmental Contract Adjustment Board.”<sup>43</sup> While the military services already had CABs in place, civilian agencies needed to develop contract adjustment board procedures. The Department of Transportation (DOT) and the Department of Energy (DOE) granted authority to their boards of contract appeals to also serve as CABs.<sup>44</sup>

Although Congress contemplated indemnification to deal with nuclear or explosive disasters, the early executive orders failed to mention indemnification authority.<sup>45</sup> These provisions were not added to the executive order until 1971.<sup>46</sup> Under the executive order, agencies may clearly incur contingency obligations of unknown amounts exceeding or in advance of appropriations, which would otherwise be prohibited by the Anti-Deficiency Act.<sup>47</sup> This contingent liability extends to damages to the

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<sup>43</sup> *Id.* at paragraph 2.

<sup>44</sup> NASH & CIBINIC, *supra* note 29, at 2247. *See also* Application of Allied Signal, Inc. For Extraordinary Relief Under 50 U.S.C. § 1431-1435, Docket No. 85-804-19, 1996 DOT BCA LEXIS 23 (Sept. 20, 1996) (describing DOT extraordinary relief procedures) and Systems Research, ECAB No. 3-8-78, 3 ECR Reporter ¶ 116, Aug. 29, 1978 (history of DOE implementation of Pub. L. 85-804).

<sup>45</sup> Legislative History, Public Law 85-804, S. Rep. No. 2281, 85th Cong., 2d Sess., *reprinted in* 1958 U.S. Code Cong. & Ad. News 4043, 4045 (“[T]he need for indemnity clauses in most cases arises from the advent of nuclear power and the use of highly volatile fuels in the missile program.”).

<sup>46</sup> Exec. Order No. 11610, 36 Fed. Reg. 13,755 (1971).

<sup>47</sup> “The limitation . . . to amounts appropriated and the contract authorization provided therefor shall not apply to contractual provisions which provide that the United States will hold harmless and indemnify the contractor against any of the claims or losses . . . resulting from risks that the contract defines as unusually hazardous or nuclear in nature.” *Id.* *See also* Anti-Deficiency Act, 31 U.S.C. § 1341 (2002).

contractor or claims by third persons for death, personal injury, or loss of, damage to, or loss of use of property.<sup>48</sup> The contractor must notify the government and allow the government, at its election, to settle or defend the indemnified action.<sup>49</sup> Authority for indemnification has been retained, unchanged, in subsequent executive orders and has been integrated into the Federal Acquisition Regulation.<sup>50</sup>

**b) Federal Acquisition Regulation (FAR) Part 50**

The FAR implements extraordinary contractual relief provisions at FAR Part 50.<sup>51</sup> Contractors identify the peculiar risks against which they desire to be indemnified and must disclose the extent of any insurance available to cover these risks.<sup>52</sup> An indemnification clause will not be added without agreement between the contractor and the government as to the covered “unusually hazardous risks.”

The FAR cautions agencies not to use this authority in a manner that encourages carelessness and laxity on the part of defense contractors.<sup>53</sup> Nor may extraordinary contractual relief be granted when other adequate legal authority exists within the agency.<sup>54</sup>

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<sup>48</sup> Exec. Order No. 11610, *supra* note 46. *See also* Exec. Order No. 13232 of Oct. 20, 2001, 66 Fed. Reg. 53,941 (2001).

<sup>49</sup> Exec. Order No. 11610, *supra* note 46.

<sup>50</sup> *Id.* *See also* Exec. Order No. 13232, *supra* note 48; FAR 50.000-50.403.

<sup>51</sup> FAR 50.000-50.403.

<sup>52</sup> FAR 50.403-1.

<sup>53</sup> FAR 51.102.

<sup>54</sup> *Id.*

The FAR mandates explicit procedures for each 85-804 mechanism (indemnification and ECR). These procedures are detailed in the next two sections.

### **c) Indemnification Procedures**

Much of this thesis turns on an appreciation of the limitations imposed on extraordinary relief under Public Law 85-804, and the agency practices applying the requirements imposed by the FAR to environmental liabilities. Contractor requests for indemnification, “shall include . . . the [i]dentification and definition of the unusually hazardous or nuclear risks for which indemnification is requested, with a statement indicating how the contractor would be exposed to them.”<sup>55</sup> The FAR also requires the contractor to disclose the extent of any insurance available to cover these risks.<sup>56</sup>

Once the request is submitted, the Contracting Officer considers the risks identified and the availability of insurance in determining whether to recommend approval.<sup>57</sup> An indemnification clause will not be added without agreement between the contractor and the government as to the covered “unusually hazardous risks.” After the parties have agreed and the agency secretary has approved the indemnification, the FAR requires the contracting officer to insert the INDEMNIFICATION UNDER PUBLIC LAW 85-804 clause (FAR 52.250-1)<sup>58</sup> in the relevant contracts.<sup>59</sup> This clause delineates

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<sup>55</sup> FAR 50.403-1.

<sup>56</sup> *Id.*

<sup>57</sup> FAR 50.403-2.

<sup>58</sup> FAR 52.250-1 provides:

(b) Under Public Law 85-804 . . . the Government shall, subject to the limitations contained in the other paragraphs of this clause, indemnify the Contractor against-

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the scope of the agreed indemnification and becomes part of the contract. It limits the relief available to risks specifically identified and to amounts above the contractor's insurance coverage.

Because of the vast sums of money at stake in any major cleanup or toxic tort suit, undoubtedly, the scope of these indemnification agreements will be hotly disputed. However, for 85-804 indemnification issues, the parties do not start in a vacuum in their efforts to construe the meaning of the terms of the contract and who (if anyone) assumed the risk of unforeseen environmental liability. The clause is peculiar to each contract and

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(1) Claims (including reasonable expenses of litigation or settlement) by third persons (including employees of the Contractor) for death; personal injury; or loss of, damage to, or loss of use of property;

(2) Loss of, damage to, or loss of use of Contractor property, excluding loss of profit; and

(3) Loss of, damage to, or loss of use of Government property, excluding loss of profit.

(c) *This indemnification applies only to the extent that the claim, loss, or damage*

*(1) arises out of or results from a risk defined in this contract as unusually hazardous or nuclear and*

*(2) is not compensated for by insurance or otherwise. Any such claim, loss, or damage, to the extent that it is within the deductible amounts of the Contractor's insurance, is not covered under this clause. If insurance coverage or other financial protection in effect on the date the approving official authorizes use of this clause is reduced, the Government's liability under this clause shall not increase as a result.*

(d) When the claim, loss, or damage is caused by willful misconduct or lack of good faith on the part of any of the Contractor's principal officials, the Contractor shall not be indemnified for-

(1) Government claims against the Contractor (other than those arising through subrogation); or

(2) Loss or damage affecting the Contractor's property. . .

(f) *The rights and obligations of the parties under this clause shall survive this contract's termination, expiration, or completion. The Government shall make no payment under this clause unless the agency head determines that the amount is just and reasonable . . . (emphasis added)*

<sup>59</sup> See FAR 50.403-3.

was specifically negotiated. There will be no relief for environmental liabilities unless these risks were specifically included. Like indemnification, each ECR request is also considered on a case-by-case basis. The next section reviews how this is done.

**d) Agency Contract Adjustment Boards (CABs)**

The INDEMNIFICATION UNDER PUBLIC LAW 85-804 clause expressly indicates circumstances justifying relief. Unless relief is sought for damages falling within the parameters specified, such relief is beyond the scope of the contract. On the other hand, broader relief for routine environmental cleanups could be sought under 85-804's contract adjustment board process.<sup>60</sup> CABs have "authority . . . to take all action necessary or appropriate . . . ."<sup>61</sup> Relief is available when the contractor is essential to national defense and the environmental costs are such that it cannot fulfill its vital defense role without emergency financial relief.<sup>62</sup> Based on volume, the DoD CABs are most important.

**e) Agency FAR Supplements**

The Department of Defense (DoD) FAR Supplement (DFARS) creates separate CABs but common procedures for the Army, Navy, and Air Force.<sup>63</sup> Contractors submit

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<sup>60</sup> FAR 50.202. FAR 50.203 imposes limits on CAB authority. No modification shall be made after all obligations of the contract have been discharged. No amendment of a negotiated contract may increase the price above the next lowest bidder. Finally, no amounts are allowed except within the limits of the amounts appropriated and authorized.

<sup>61</sup> The limits constrain an otherwise unbounded authority: "An agency head may establish a FAR 50.202.

<sup>62</sup> FAR 50.302-1(a), 50.304-50.305.

<sup>63</sup> Defense Federal Acquisition Regulation Supplement [hereinafter DFARS] 250.202, 48 C.F.R. § 250.202 (2002). The military services have issued supplements providing greater detail about the nuts and bolts of processing their contract cases. *See* for example Air Force Federal Acquisition Regulation Supplement [hereinafter AFFARS] 5350.305-90, 48 C.F.R. § 5350.305-90 (2002).

requests for extraordinary relief to the contracting officer explaining why the matter could not be resolved under the contract and, where appropriate, facts and evidence justifying why the contractor is essential to the national defense.<sup>64</sup> Contracting officers prepare a report recommending approval or denial for the CAB, with a statement of why the relief (if recommended) is in the interest of national defense.<sup>65</sup> They forward their recommendations with the contractor's request for relief and any financial data or other pertinent documents. The CAB then decides "as expeditiously as practicable."<sup>66</sup> In dire circumstances, adjustment boards act very quickly.<sup>67</sup>

Now that indemnification and ECR under Public Law 85-804 have been explained, the thesis will examine liability for environmental damages. The following section discusses the types of environmental liability for which the contractor would be most likely to seek 85-804 relief. While the emphasis is on CERCLA and toxic torts, other environmental requirements are briefly discussed for the sake of completeness and to foster an appreciation of why they are not as important for 85-804 consideration.

## **B. Liability for Environmental Damages**

Contractors are confronted by numerous difficulties when trying to recover from the government under environmental laws or the Federal Tort Claims Act. These difficulties are discussed at length below. Later, "the government contractor defense" is explored as a mechanism for contractors to enjoy limited immunity from toxic tort suits.

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<sup>64</sup> DFARS 250.303, 250.305-71. *See also* FAR 50.304(a)(5), 50.302-1, 50.304 (b)(1).

<sup>65</sup> DFARS 250.305-71.

<sup>66</sup> DFARS 250.305-72.

<sup>67</sup> *See Avtex, infra* notes 355-359 and accompanying text.

“Modern environmental law began with the Clean Air Act (CAA)<sup>68</sup> Amendments of 1970 and the Federal Water Pollution Control Act (FWPCA)<sup>69</sup> Amendments of 1972.”<sup>70</sup> Since 1970, a plethora of environmental statutes have been passed governing virtually every facet of pollution. These laws carry with them a range of administrative, civil and even criminal penalties for noncompliance.<sup>71</sup> Many also contain citizen suit provisions to allow affected citizens to sue for compliance when state and federal regulators have neglected to do so.<sup>72</sup> Private parties injured by pollution can also sue in their own right. For three reasons, this thesis focuses exclusively on cleanup costs and liability for toxic torts (as opposed to compliance considerations).

First, the costs of cleanup and/or third party liability often dwarf the monetary consequences related to noncompliance.<sup>73</sup> To put these comparative liabilities in perspective, Exxon paid about \$125 million for violating environmental laws incident to the Exxon

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<sup>68</sup> Pub. L. No. 91-604, 84 Stat. 1676 (1970) (codified as amended at 42 U.S.C. §§ 7401-7671q (2002)).

<sup>69</sup> Pub. L. No. 92-500, 86 Stat. 896 (1972) (also known as the Clean Water Act) (codified as amended at 33 U.S.C. §§ 1251-1387 (2002)).

<sup>70</sup> ARNOLD W. REITZE JR., AIR POLLUTION CONTROL LAW: COMPLIANCE AND ENFORCEMENT 569 (2001).

<sup>71</sup> See e.g., 42 U.S.C. § 6928 (2002) (Resource Conservation and Recovery Act (RCRA)), 33 U.S.C. §§ 1319 and 1321 (2002) (FWPCA), 42 U.S.C. § 9603(b) (2002) (CERCLA), and 42 U.S.C. § 7413 (2002) (CAA).

<sup>72</sup> See e.g., 42 U.S.C. § 6972 (2002) (RCRA), 33 U.S.C. § 1365 (2002) (FWPCA), 42 U.S.C. § 9659 (2002) (CERCLA), and 42 U.S.C. § 7604 (2002) (CAA).

<sup>73</sup> Arnold W. Reitze Jr., Lecture in Environmental Enforcement Law, George Washington University Law School, Feb. 7, 2002 (author was in attendance).



Valdez oil spill compared to over \$2.1 billion for environmental cleanup.<sup>74</sup> Tort liability can also be extreme when environmental consequences are severe and the jury perceives a corporation to be a bad actor. The jury awarded \$287 million in compensatory damages and \$5 billion in punitive damages to commercial fishermen due to the Exxon Valdez pollution.<sup>75</sup> The \$5 billion (since remanded for redetermination) “was then the largest punitive damages award in American history.”<sup>76</sup>

Second, 85-804 indemnification extends only to third-party claims or claims for loss or damage of the contractors’ or government property<sup>77</sup>—it does not extend to fines and penalties for non-compliance. Finally, costs of daily compliance (and fines or penalties associated with noncompliance) are seen by some contractors as simply a cost of doing business and hardly rise to a level warranting extraordinary relief. A 2002 article in the Federal Contracts Reporter notes that according to a watchdog group the largest federal contractors violate laws, including environmental laws, with impunity.<sup>78</sup>

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<sup>74</sup> *In re Exxon Valdez*, 270 F.3d 1215, 1244-46 (9th Cir. 2001). Exxon also agreed to pay \$900 million over and above cleanup costs to restore damaged natural resources. *Id.* at 1223.

<sup>75</sup> *Id.* at 1225. From the \$287 million in compensatory damages awarded, the court deducted “released claims, settlements, and payments by the Trans-Alaska Pipeline Liability Fund to find net compensatory damages of \$19,590,257.” *Id.* However, in terms of third-party liability, Exxon had voluntarily paid \$300 million in settlements prior to any judgements being entered against it. *Id.* at 1223.

<sup>76</sup> Punitive damages were remanded to be reduced in the wake of the Supreme Court’s decisions in *BMW of North America v. Gore*, 517 U.S. 559 (1996) and *Cooper Industries Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424 (2001). *Id.* at 1225, 1246-47.

<sup>77</sup> FAR 52.250-1.

<sup>78</sup> *Largest Federal Contractors Break Laws with Impunity, Oversight Project Reports*, 77 FED. CONT. REP. 19 at 563 (BNA May 14, 2002).

## **1. Government Cleanup Liability**

Both the Resource Conservation and Recovery Act (RCRA)<sup>79</sup> and the Comprehensive Environmental Response Compensation and Liability Act (CERCLA)<sup>80</sup> create statutory schemes to clean up hazardous waste. While most of CERCLA is focused on cleanup and restoration of the environment, RCRA authority for “corrective actions” is found only in 42 U.S.C. §§ 6924(u)-(v), 6928(h), and 6973. CERCLA applies whenever a facility is listed on the National Priority List (NPL) (those sites believed to pose the greatest risk). Once listed, CERCLA controls.<sup>81</sup> CERCLA was modified in 2002 to defer listing on the NPL if a “State or another party under an agreement with or order from the State, is conducting a response action” in compliance with a state program that that will provide long-term protection of human health and the environment.<sup>82</sup> The wording is broad enough to allow either State-authorized RCRA corrective actions or State Superfund cleanups to defer NPL-listing.

### **a) RCRA**

RCRA contains an explicit waiver of sovereign immunity.<sup>83</sup> In 1984, cleanup requirements (known as corrective actions) were added to RCRA’s compliance

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<sup>79</sup> Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901-6992 (2002) [hereinafter RCRA].

<sup>80</sup> 42 U.S.C. §§ 9601-9675 (2002).

<sup>81</sup> 42 U.S.C. § 9605 (2002).

<sup>82</sup> Pub. L. No. 107-118 (codified at 42 U.S.C. § 9605(h) (2002)).

<sup>83</sup> RCRA specifies that the federal government “shall be subject to, and comply with, all Federal, State, interstate, and local requirements” including injunctive relief and sanctions (civil and administrative penalties or fines). 42 U.S.C. § 6961(a) (2002).

mandates.<sup>84</sup> The EPA or state hazardous waste administrator “shall require corrective action for all releases of hazardous waste . . . from any solid waste management unit [SWMU] at a treatment, storage or disposal facility seeking a [RCRA] permit . . . .”<sup>85</sup> EPA estimates there to be over 80,000 SWMUs subject to RCRA-permitted cleanups.<sup>86</sup> Cleanup nationwide is expected to cost between \$18 and \$42 billion plus an additional \$3 to \$18 billion for federal facilities.

The Supreme Court explained RCRA relief includes only a prohibitory injunction (restraining a responsible party from violating RCRA) or a mandatory injunction (ordering a responsible party to cleanup toxic waste).<sup>87</sup> RCRA has no mechanism for shifting incurred cleanup costs to another polluter. However, contractors who have spent money on cleanup can seek such relief under CERCLA.<sup>88</sup>

#### **b) CERCLA/SARA**

CERCLA also waives sovereign immunity.<sup>89</sup> Congress modified CERCLA in 1986 by the Superfund Amendments and Reauthorization Act (SARA)<sup>90</sup> creating a

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<sup>84</sup> The Hazardous and Solid Waste Amendments of 1984, Pub. L. No. 98-616 (1984) (codified at 42 U.S.C. § 6924(u) (2002)).

<sup>85</sup> *Id.*

<sup>86</sup> John Graubert, *Corrective Action Under RCRA*, C883 ALI-ABA 117, 24th Annual Environmental Law Conference, Feb. 17, 1994.

<sup>87</sup> *Meghrig v. KFC Western, Inc.*, 116 S. Ct. 1251, 1254 (1996).

<sup>88</sup> 42 U.S.C. § 9613(f)(1) (2002).

<sup>89</sup> CERCLA defines the United States as a “person” and makes any person liable for response costs incurred in accordance with the National Contingency Plan. 42 U.S.C. §§ 9601(21) and 9607(a) (2002).

<sup>90</sup> SARA, *supra* note 16.

specific “Federal Facilities” Section at 42 U.S.C. § 9620.<sup>91</sup> The Supreme Court has read the language of 42 U.S.C. §§ 9620(a)(1) “as an unambiguous waiver of the sovereign immunity of the United States.”<sup>92</sup>

### 1) CERCLA Fundamentals

In 1980, “after a decade of nightmarish environmental episodes from leaky landfills to Love Canal, [Congress] created the ways and means to start cleaning up: the Superfund.”<sup>93</sup> One of the Superfund’s principle remedial objectives was the expeditious cleanup of contaminated sites.<sup>94</sup> Quick cleanup reduces risks to the public now and defers the question of who ultimately pays until later. The second major principle is that the “polluter pays.” Those “responsible for damage, environmental harm, or injury from chemical poisons [pay for] the costs of their actions.”<sup>95</sup> The logic of the polluter pays

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<sup>91</sup> 42 U.S.C. § 9620(a)(1) provides, “Each department . . . of the United States . . . shall be subject to, and comply with, this chapter . . . both procedurally and substantively, as any nongovernmental entity, including liability under section 9607 of this title.”

<sup>92</sup> *United States ex rel. Cal. Dep’t. of Health Servs. v. Shell Oil Co.*, 281 F.3d 812 (9th Cir. 2002) citing *Pennsylvania v. Union Gas Co.*, 491 U.S. 1,7 (1989). The United States is liable under § 9620 only when it qualifies as an owner or operator of a facility, an arranger of waste disposal, or an entity that accepts waste for treatment or disposal. *Shell Oil* at 820.

<sup>93</sup> Tom Zeller, *The Future of Superfund: More Taxing, Less Simple*, N.Y. TIMES, Mar. 24, 2002, at D16. The article notes also that taxpayers are paying to replenish the Superfund, which, prior to 1995, was funded by a tax on the oil and chemical industries.

<sup>94</sup> S. REP. NO. 96-848, 96th Cong. 2d Sess. 12, 13 (1980). *See also* *Boeing Co. v. Cascade Corp.*, 207 F.3d 1177, 1191 (9th Cir. 2000) (CERCLA was intended to encourage quick response and to place the costs on those responsible).

<sup>95</sup> CERCLA’s “essential purpose [is] making those responsible for problems caused by the disposal of chemical poisons bear the costs and responsibility for remedying the harmful conditions they created.” *Lansford-Coaldale Joint Water Auth. v. Tonolli Corp.*, 4 F.3d 1209, 1221 (3d Cir. 1993) (internal quotation marks omitted), citing 125 Cong. Rec. 17989 (1979) (statement of Senator John C. Culver of Iowa), *reprinted in*, 1 Senate Continued Next Page

principle “seems unassailable, its down-home clean-up-after-yourself sentiment familiar and right.”<sup>96</sup> While the concept is simple, its application is anything but. Sorting out who polluted and who pays is frequently the subject of lengthy and complex litigation. The remainder of this section looks at who pays under CERCLA. Government contractors are frequently dissatisfied with this scheme.

CERCLA imposes strict liability<sup>97</sup> for the cost of responding to and cleaning up hazardous contamination on four classes of potentially responsible parties (PRPs): owners, operators, arrangers, and transporters.<sup>98</sup> The class of owner and operator PRPs is further subdivided into those who *presently* own and operate a facility which released hazardous waste and those who owned or operated the facility *at the time of the release*.<sup>99</sup>

When the federal government owns the contaminated site, there is rarely an issue of government liability as a PRP. The government agency that owns the property serves as the lead agency for the cleanup (funding most or all of the costs).<sup>100</sup> This situation

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Committee on Environment and Public Works, A Legislative History of CERCLA, Pub. Law 96-510 at 148-49 (Comm. Print 1983).

<sup>96</sup> Zeller, *supra* note 93.

<sup>97</sup> Although the statute itself never uses this terminology, the courts have been consistent in such application, “to fulfill the remedial purposes of the statute.” *United States v. Alcan Aluminum Corp.*, 964 F.2d 252, 258-59 (3d Cir. 1992).

<sup>98</sup> 42 U.S.C. § 9607(a)(1-4) (2002).

<sup>99</sup> 42 U.S.C. § 9607(a)(1-2) (2002). *See also* *FMC Corp. v. United States Dep't. of Commerce*, 29 F.3d 833 (3d Cir. 1994) (entity that becomes an owner of a facility after the disposal of the hazardous waste is liable under CERCLA).

<sup>100</sup> *See* 42 U.S.C. § 9620(e) (2002) and Exec. Order No. 12580 (delegating President's CERCLA authority for cleanup of DoD facilities to DoD; DoD has redelegated to the military services). *See also* 10 U.S.C. § 2701 *et seq.* (2002), governing the Department of Defense (DoD) Environmental Restoration Program (DERP). As part of SARA the

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occurs where a contractor operates on a federal installation or at a government-owned, contractor-operated (GOCO) facility. Similarly, in DOE, the management and operations (M&O) contractors work on federal land.<sup>101</sup> At a GOCO or M&O facility, government liability as a PRP simply stems from its present ownership of polluted property.<sup>102</sup>

Government liability is less certain when the government does not own the contaminated land. The three sections below explore the three ways to prove the government is a PRP when the government does not own the cleanup site. The government will be a PRP if it owned the facility at the time of disposal, operated the facility at the time of disposal, or arranged for the disposal of the hazardous waste that needs to be remediated.

#### **a. Owner Liability at the Time of Disposal**

CERCLA allows recovery from, “any person who *at the time of disposal* of any hazardous substance *owned or operated any facility* at which such hazardous substances were disposed of.”<sup>103</sup> The term “facility” has been broadly defined to reach beyond landowners, it includes:

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Defense Environmental Restoration Account (DERA) was created to fund DoD liability for presently owned and previously owned sites (now segregated into separate accounts for each military service). 10 U.S.C. § 2703 (2002). Congress appropriated more than \$1.8 billion for this program for fiscal year 2002. Fiscal year 2001 DERP results are available at: <[http://www.defenselink.mil/news/Apr2002/b04112002\\_bt175-02.html](http://www.defenselink.mil/news/Apr2002/b04112002_bt175-02.html)> (site last visited May 29, 2002).

<sup>101</sup> See text accompanying notes 295 to 299 *supra*, where M&O contractor considerations are discussed in more detail.

<sup>102</sup> 42 U.S.C. § 9607(a)(1) (2002) (covered persons includes “owner and operator of a vessel or a facility”).

<sup>103</sup> 42 U.S.C. § 9607(a)(2) (2002) (emphasis added).

(A) any building, structure, installation, equipment, pipe or pipeline (including any pipe into a sewer or publicly owned treatment works), well, pit, pond, lagoon, impoundment, ditch, landfill, storage container, motor vehicle, rolling stock, or aircraft, or (B) any site or area where a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise come to be located; but does not include any consumer product in consumer use or any vessel.<sup>104</sup>

Facilities clearly include land contaminated by a past owner. The Army Corps of Engineers spearheads the defense department cleanup of Formerly Used Defense Sites (FUDS).<sup>105</sup> Of over 9000 potential FUDS identified, 2676 sites were found to have sufficiently high levels of contamination to require cleanup.<sup>106</sup> Of these, only 463 were excluded because other parties were deemed responsible for the hazards.<sup>107</sup> The FUDS program evidences government accountability for pollution as the landowner at the time of disposal (liability extends to former GOCOs, training ranges, installations, etc.).

Because of the broad definition of “facility” in CERCLA and an equally broad definition of “government property” under the FAR,<sup>108</sup> contractors argue that the government is liable when it owns the equipment which generates the pollution, even though the underlying property belongs to the contractor. In *Elf Atochem N. Am. v.*

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<sup>104</sup> 42 U.S.C. § 9601(9) (2002).

<sup>105</sup> GAO estimates it will cost \$13-18 billion to clean up hazards at FUDS; however, since funding for FUDS cleanup is only about \$200 million annually, restoration of these sites is expected to take 70 years. ENVIRONMENTAL CONTAMINATION: CLEANUP ACTIONS AT FORMERLY USED DEFENSE SITES, GAO-01-557 (July 2001) at 1, 3, and 12.

<sup>106</sup> *Id.* at 12.

<sup>107</sup> *Id.*

<sup>108</sup> FAR 45.101 (government property includes both government furnished property and property acquired by the contractor for performing a contract and to which the government has title).

*United States* [hereinafter *Elf Atochem*], a federal district court held that because the United States owned facilities (the equipment) that disposed of hazardous waste that was released into the environment and generated response costs, the government was liable.<sup>109</sup>

In a recent Ninth Circuit Case, *United States ex rel. Cal. Dep't of Health Servs. v. Shell Oil Co.* [hereinafter *Shell Oil*], the government tried to limit its CERCLA liability to the confines of a "federal facility."<sup>110</sup> Relying on the heading "Federal Facilities" at the beginning of 42 U.S.C. § 9620, the government argued unsuccessfully that Congress intended to waive sovereign immunity only with respect to disposals at federally owned facilities. The court disagreed and held that the United States could be liable as a facility owner or operator, or as an arranger, even where the disposal did not occur at the federal facility.<sup>111</sup> Taken together, these cases indicate the government may be a PRP when it owns the equipment causing the pollution even when that equipment is operated at the contractor's facility. The following sections address liability when the government was not a facility owner.

#### **b. Operator Liability at the Time of Disposal**

The United States Supreme Court established a rigorous "actual control" test for operator liability in the 1998 case *United States v. Bestfoods* [hereinafter *Bestfoods*].<sup>112</sup> "An operator must manage, direct, or conduct operations specifically related to pollution,

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<sup>109</sup> *Elf Atochem N. Am. v. United States*, 868 F. Supp. 707, 713 (E.D. Pa. 1994) (citing 42 U.S.C. § 9607(a)(2) as the authority for liability).

<sup>110</sup> *United States ex rel. Cal. Dep't. of Health Servs. v. Shell Oil Co.* [hereinafter *Shell Oil*], 281 F.3d 812, 819-20 (9th Cir. 2002).

<sup>111</sup> Although in this case it was not. *Id.*

<sup>112</sup> *United States v. Bestfoods*, 524 U.S. 51, 55 (1998).



that is, operations having to do with the leakage or disposal of hazardous waste, or decisions about compliance with environmental regulations.”<sup>113</sup> *Bestfoods* invalidated previous decisions by lower courts using a “potential to control” or “authority to control” pollution standard.<sup>114</sup> Thus, while many corporations cling to such theories as a means of attaching CERCLA liability to the government, these approaches should no longer prevail. The actual control test benefits the government by making it much more difficult to establish government operator liability.

In *Shell Oil*, the Ninth Circuit held that authority to control alone was inadequate. The government “could have exercised control over the disposal of the waste, just as it could have seized the Oil Companies’ refineries under eminent domain and operated those refineries itself.”<sup>115</sup> Instead, the court found the United States did not exercise actual control over the oil companies’ disposal of spent acid and acid; “indeed, it did not even know that the Oil Companies had contracts to dispose of their waste at the site.”

In *United States v. Kayser-Roth Corp.*, the First Circuit applied the *Bestfoods* test to hold a parent corporation liable for the acts of the subsidiary, because “the evidence indicated that the corporation directly exerted operational control over environmental

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<sup>113</sup> *Id.* at 66-67.

<sup>114</sup> See e.g., *FMC Corp. v. United States Dep't. of Commerce*, 29 F.3d 833 (3d Cir. 1994) (en banc) [hereinafter *FMC*]. *FMC*’s facility was purchased from a company, which, during World War II, at the behest of and under the direction of the government produced high tenacity rayon—“it simply is not accurate to say that the government’s activities at the facility were limited to government-owned equipment and machinery, when the government’s overriding concern was the efficient operation of the facility as a whole.” There was no indication, however, that such control included the waste handling and disposal decisions. See facts detailed at 29 F.3d 851-855 (Sloviter, C. J. dissenting).

<sup>115</sup> *Shell Oil*, *supra* note 110, at 825 (citations omitted).

matters at the plant.”<sup>116</sup> Other recent Circuit Court decisions also have uniformly applied the *Bestfoods* standard to assess operator liability.<sup>117</sup> A nexus must link the entity's control with the hazardous waste—operator liability only attaches if the defendant controls the cause of the contamination at the time the hazardous substances were released into the environment.<sup>118</sup>

The tough standards hurt contractors by making it nearly impossible to prove the government is a PRP through operator liability. Another avenue is, however, available. PRP status also attaches to those who arrange for the waste disposal.

### **c. Arranger Liability for the Disposal**

CERCLA specifies that an arranger is a “covered person” liable for cleanup.<sup>119</sup> The concept is that those who arrange for the treatment or disposal of hazardous wastes should be held responsible for cleanup costs so that they will internalize the full costs that hazardous substances impose on society.<sup>120</sup>

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<sup>116</sup> *United States v. Kayser-Roth Corp.*, 272 F.3d 89 (1st Cir. 2001).

<sup>117</sup> *See e.g.*, *Geraghty & Miller, Inc. v. Conoco Inc.*, 234 F.3d 917 (5th Cir. 2000); *United States v. Twp. of Brighton*, 282 F.3d 915 (6th Cir. 2002) (remanding to the district court for reconsideration using the actual control standard); *Maytag Corp. v. Navistar Int'l Transp. Corp.*, 219 F.3d 587 (7th Cir. 2000) (applying *Bestfoods* standard in Bankruptcy context); *United States v. Hansen*, 262 F.3d 1217 (11th Cir. 2001) (applying *Bestfoods* test in context of failure to report a release of hazardous waste).

<sup>118</sup> *Geraghty & Miller, Inc.*, *Id.* at 928 (citations omitted).

<sup>119</sup> 42 U.S.C. § 9607(a)(3) (2002) states:

[A]ny person who by contract, agreement, or otherwise arranged for disposal or treatment . . . of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances . . . shall be liable . . . .

Two theories of arranger liability have been advanced, “direct” and “broader” arranger liability. “Direct arranger liability” occurs where the “sole purpose of the transaction is to arrange for the treatment or disposal of the hazardous wastes.”<sup>121</sup> A direct arranger must have direct involvement in arrangements for the waste disposal.<sup>122</sup> This is a routine situation when the government contracts for disposal of its hazardous waste in accordance with RCRA. In contrast, “broader arranger liability” concerns waste disposal that arises as a byproduct from a manufacturing process versus a direct arrangement to dispose of toxic waste.

For instance, in *Shell Oil* the oil companies argued for arranger liability on a broader theory, contending that the government had substantial control over a manufacturing process wherein a hazardous waste stream was generated and disposed of.<sup>123</sup> The pollution in *Shell Oil* was a byproduct of the manufacture of avgas for the military in WWII. The court was willing to consider broader arranger liability, but focused on actual control involved versus authority to control and was unwilling to impose the less demanding standard.

The *Shell Oil* court viewed the United States more like a customer than a manufacturer. It therefore distinguished the Eighth Circuit case, *United States v. Aceto*

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<sup>120</sup> FMC Corp. v. United States Dep't of Commerce, 29 F.3d 833 (3d Cir. 1994).

<sup>121</sup> *Shell Oil*, *supra* note 110, at 821.

<sup>122</sup> See, e.g., Cadillac Fairview, Inc. v. United States, 41 F.3d 562 (9th Cir. 1994) (rubber companies that had transferred contaminated styrene to Dow Chemical for reprocessing were held to be arrangers).

<sup>123</sup> *Shell Oil*, *supra* note 110, at 821-22.

*Agric. Chem. Corp.* [hereinafter *Aceto*], where broader arranger liability was found.<sup>124</sup>

*Aceto* concerned a pesticide manufacturer that sent its technical grade pesticides to another company for reformulation for commercial sale.<sup>125</sup> The court in *Aceto* would not allow the manufacturer to avoid arranger liability for the hazardous wastes generated from the reformulation process.<sup>126</sup> *Aceto* is often cited for the proposition that a manufacturer cannot escape liability by simply having the hazardous waste-producing functions performed by another company. “[A] party is . . . an arranger (1) if it supplies raw materials to be used in making a finished product, (2) and it retains ownership or control of the work in progress, (3) where the generation of hazardous substances is inherent in the production process.”<sup>127</sup> In *Shell Oil*, the United States never owned any of the raw materials or intervening products and never sought (unlike the *Aceto* manufacturers) a crucial, waste-producing process that was a byproduct of its own toxic raw materials.

Instead, *Shell Oil* found a closer approximation for analyzing arranger liability in the case of *United States v. Vertac Chem. Corp.* [hereinafter *Vertac*].<sup>128</sup> *Vertac* addressed whether the United States was liable as an arranger for cleanup costs at a plant that had manufactured Agent Orange during the Vietnam War. In both *Shell Oil* and *Vertac*, contractors manufactured products for purchase by the United States in wartime.

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<sup>124</sup> *United States v. Aceto Agric. Chem. Corp.*, 872 F.2d 1373 (8th Cir. 1989).

<sup>125</sup> *Id.* at 1375.

<sup>126</sup> *Id.* at 1382.

<sup>127</sup> *Shell Oil*, *supra* note 110, at 822 (quoting the standard its lower court followed based on *Aceto* (citations omitted)).

<sup>128</sup> *United States v. Vertac Chem. Corp.*, 46 F.3d 803 (8th Cir. 1995).

Contractors in both cases performed government contracts pursuant to government programs with priority over other manufacturing. In both cases, the companies voluntarily entered into the contracts and profited from the sales. In both cases, the United States knew that waste was being produced, but did not direct the manner of waste disposal.<sup>129</sup> Both *Shell Oil* and *Vertac* held that the United States was not an arranger under 42 U.S.C. § 9607(a)(3), even under a broad theory of arranger liability.<sup>130</sup>

## 2) Disadvantages of CERCLA

As shown above, CERCLA recovery from the government is difficult for contractors manufacturing products at contractor-owned facilities. Particularly in the past few years, proving the government is a PRP is problematic when trying to establish government liability as an operator or arranger. The cost risk of Superfund cleanups is also daunting for many other reasons. CERCLA is retroactive.<sup>131</sup> Liability is strict and typically joint and several.<sup>132</sup> Compliance costs are staggering.<sup>133</sup> Cleanup costs

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<sup>129</sup> *Shell Oil*, *supra* note 110.

<sup>130</sup> *Id.* at 826.

<sup>131</sup> Although the U.S. Supreme Court has not expressly addressed this issue, two U.S. Circuit Courts of Appeals have specifically upheld the retroactive application of CERCLA in the face of due process challenges: *United States v. Northeastern Pharm. & Chem. Co.*, 810 F.2d 726 (8th Cir. 1986) (retroactive application of CERCLA did not violate arranger's constitutional right to due process); and, *United States v. Monsanto Co.*, 858 F.2d 169, 174 (4th Cir. 1988) (CERCLA applied retroactively to spread costs "among all parties that played a role in creating the hazardous conditions.").

<sup>132</sup> *United States v. Davis*, 261 F.3d 1, 49 (1st Cir. 2001).

<sup>133</sup> See \$400 Billion Toxic Cleanup Bill, WASH. POST, July 18, 1996, at A25. See also SUPERFUND: PROGRESS MADE BY EPA, *supra* note 8.

invariably escalate beyond anticipated costs.<sup>134</sup> Finally, the possibly overwhelming costs of abating natural resource damages linger, even after the site has been cleaned up.<sup>135</sup>

CERCLA seems most unfair<sup>136</sup> because liability is retroactive, penalizing practices that were not improper at the time.<sup>137</sup> Even if a facility complies with all

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<sup>134</sup> A 1993 GAO report criticizes EPA's management of CERCLA contractors: "costs to clean [Superfund sites] continue to escalate . . . EPA's performance [maximizing use of scarce resources for cleanup] is poor, with a high proportion of Superfund dollars being spent on program management and indirect costs." SUPERFUND, EPA ACTION COULD HAVE MINIMIZED PROGRAM MANAGEMENT COSTS, GAO/T-RCED-93-50, Jun. 10, 1993. When GAO last revisited this issue, it noted improvement but nevertheless concluded, "excessive amounts are still being spent on administrative support costs." PROGRESS MADE BY EPA AND OTHER FEDERAL AGENCIES TO RESOLVE SUPERFUND PROGRAM MANAGEMENT ISSUES, GAO/RCED-99-111, Apr. 1999. A 1994 GAO report notes that the Army's cost to clean up Rocky Mountain Nuclear Arsenal will be 70 percent more than projected. ENVIRONMENTAL CLEANUP: INCONSISTENT SHARING ARRANGEMENTS MAY INCREASE DEFENSE COSTS, NSIAD-94-231, July 7, 1994. A 2001 GAO estimate for a \$9 billion cleanup by the Department of Energy suggests completion on schedule is unlikely and "taking another two years to complete the project, for example, could add about \$530 million...." PROGRESS MADE AT ROCKY FLATS, BUT CLOSURE BY 2006 IS UNLIKELY, AND COSTS MAY INCREASE, GAO-01-284, Feb. 2001, at 18 (Table 2).

<sup>135</sup> The State of New Mexico filed a claim under the Federal Tort Claims Act for \$2 billion for natural resource damages allegedly caused at a former government-owned contractor-operated facility, Air Force Plant 83, in the South Valley of Albuquerque, New Mexico. (This author represented the Air Force in defense of the claim). New Mexico also simultaneously sued in the Federal District Court in New Mexico for the same natural resource damages under CERCLA (42 U.S.C. § 9607(a)(1-4)(C)). Litigation is ongoing and damages sought now exceed \$4 billion. Interview of David McCray, Chief of Air Force Environmental Litigation Torts Branch, and trial attorney detailed to the Department of Justice on this case, May 23, 2002. The damages sought are above and beyond the CERCLA cleanup costs expended (approximately \$100 million) to restore the groundwater and contaminated soil (1.2 million gallons of water meeting drinking water standards are pumped daily at the site). *Id.*

<sup>136</sup> Fairness is an issue because contractors are afforded an avenue to seek extraordinary contractual relief based on fairness under Public Law 85-804 (*see infra* Section VI.B.2).

<sup>137</sup> The Supreme Court has stated:

the presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our

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requirements of the other environmental statutes, if the byproduct of disposal is later determined to pose a threat to human health and the environment, the owner or operator can nevertheless be required to ameliorate that threat under CERCLA. The consequences are especially onerous for contractors supporting United States wartime production needs, because the contractors had no choice but to support the war effort.<sup>138</sup> CERCLA does not provide a defense in such circumstances; rather, its harsh effects are mitigated by allowing responsible parties who have incurred cleanup costs to sue other polluters for reimbursement.<sup>139</sup> These considerations are discussed next.

**a. Act of War Defense Does Not Protect Wartime Contractors**

CERCLA allows an “act of war” defense. “[T]here shall be no liability . . . for a person otherwise liable who can establish by a preponderance of the evidence that the release or threat of release of a hazardous substance and the damages resulting therefrom were caused solely by . . . an act of war.”<sup>140</sup> Unfortunately, CERCLA does not define the term “act of war.”

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republic. Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly; settled expectations should not be lightly disrupted.

Landgraf v. USI Film Prods., 511 U.S. 244, 265 (1994) (footnotes omitted).

<sup>138</sup> See FMC Corp. v. United States Dep't of Commerce, 29 F.3d 833 (3d Cir. 1994) (compelling the production of high tenacity rayon needed during WWII). Cf. Shell Oil, *supra* note 110 (contractors volunteered and worked for profit).

<sup>139</sup> CERCLA § 113(f) allows courts to equitably allocate response costs among potentially responsible parties (PRPs). 42 U.S.C. § 9613(f) (2002).

<sup>140</sup> 42 U.S.C. § 9607(b)(2) (2002).

*Shell Oil* is the most recent case to consider whether contamination stemming from production in support of the United States war effort qualifies for the act of war defense.<sup>141</sup> The court noted, “the argument that any governmental act taken by authority of the War Powers Clause is an ‘act of war’ sweeps too broadly.”<sup>142</sup> In rejecting the defense, the court concluded that, because there were other disposal options, pollution was not “solely” caused by an act of war:

The undisputed facts indicate that the Oil Companies had other disposal options for their acid waste, that they dumped acid waste both before and after the war, that they dumped acid waste from operations other than avgas production at the McColl site, and that they were not compelled by the government to dump waste in any particular manner.<sup>143</sup>

Because the bar has been set so high, wartime production contractors have never benefited from this defense. Since such CERCLA liability cannot be avoided, the best a contractor can hope for is to share this liability with the government through contribution.

**b. CERCLA Contribution Actions are Equitable—Liability is Shared**

Those incurring response costs under CERCLA may seek contribution from any other person who is liable or potentially liable. A court may, in its discretion, “allocate response costs among liable parties using such equitable factors as the court determines are appropriate.”<sup>144</sup> Deciding what is appropriate is no easy task.

Furthermore, the burden of proof lies with the party seeking contribution. A plaintiff seeking contribution must prove that: (1) the defendant falls within one of the

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<sup>141</sup> *Shell Oil*, *supra* note 110, at 827.

<sup>142</sup> *Id.*

<sup>143</sup> *Id.* at 827-28.

<sup>144</sup> 42 U.S.C. § 9613(f)(1) (2002).



four categories of PRPs; (2) a release or threatened release of hazardous waste involving the defendant occurred; (3) the release or threatened release caused the incurrence of response costs; and (4) the costs were necessary and consistent with the national contingency plan.<sup>145</sup>

In a CERCLA cost recovery action involving multiple PRPs, no causal link is required between costs incurred and an individual PRP's waste.<sup>146</sup> Courts have held "[o]nce a party is liable, it is liable for its share, as determined by Section 9613(f), of 'any' and all response costs, not just those costs 'caused' by its release."<sup>147</sup>

A party can reduce its equitable share by entering into a settlement agreement with the regulator. A party who settles with the government "shall not be liable for claims for contribution regarding matters addressed in the settlement."<sup>148</sup> CERCLA envisions that non-settling parties may bear disproportionate liability. The policy fosters settlement by protecting the settling party and putting the risk of increased costs on the non-settling parties. Those who immediately own up to their responsibilities are rewarded; those who do not are punished. "This paradigm is not a scrivener's accident.

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<sup>145</sup> See *United States v. Davis*, 261 F.3d 1, 29 (1st Cir. 2001) citing *Acushnet*, 191 F.3d 69, 75 (1st Cir. 1999) and 42 U.S.C. § 9607.

<sup>146</sup> *Id.* at 44. See also *Amoco Oil Co. v. Borden, Inc.*, 889 F.2d 664, 670 n.8 (5th Cir. 1989) ("In cases involving multiple sources of contamination, a plaintiff need not prove a specific causal link between costs incurred and an individual generator's waste.").

<sup>147</sup> *Control Data Corp. v. S.C.S.C. Corp.*, 53 F.3d 930, 936 (8th Cir. 1995). See also *Tosco Corp. v. Koch Indus., Inc.*, 216 F.3d 886, 891 (10th Cir. 2000) and *United States v. Davis*, *supra* note 145.

<sup>148</sup> 42 U.S.C. § 9613(f)(2) (2002).

It was designed to encourage settlements and provide PRPs a measure of finality in return for their willingness to settle.”<sup>149</sup>

Case law regarding cost allocation is sparse. PRPs and EPA increasingly look to cost causation principles, using the Gore factors<sup>150</sup> (toxicity, volume, involvement of the parties in disposal, degree of care exercised, cooperation with regulators, ability to distinguish contribution) together with other equitable factors (ability to pay, benefits to parties from contaminating activities, relative fault, culpability, etc.) to fairly allocate costs.<sup>151</sup>

For purposes of this thesis, CERCLA’s equitable sharing of liability among PRPs is an important factor motivating contractors to seek other relief from the government. Even when contractors prevail under CERCLA, they may continue to shoulder some of the expense, whereas indemnification or extraordinary relief theoretically provides a complete recovery.

## **2. Toxic Torts**

Contractors who have polluted may also face extensive third-part liability for state and common law torts. In the last twenty years, dramatic population growth and urban sprawl pushed development into previously remote areas where toxic dumping and

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<sup>149</sup> United States v. Davis, *supra* note 145, at 49. “CERCLA seeks to provide EPA with the necessary tools to achieve prompt cleanups. One such tool is the ability to foster incentives for timely settlements.”

<sup>150</sup> Named for then-Rep. Albert Gore, Jr. based on an unsuccessful amendment to CERCLA he had proposed. See White and Butler, *infra* note 151 at 10070. See *id.* at n.19 for a chronicle of cases applying these principles.

<sup>151</sup> Richard Lane White and John C. Butler, III, *Applying Cost Causation Principles in Superfund Allocation Cases*, 28 ELR 10067, 10070, 10081-82 (Feb. 1998).

manufacturing frequently occurred.<sup>152</sup> These factors, coupled with scientific advances in investigative technology have collectively raised societal awareness of the toxic implications of historic pollution, “triggering an epidemic of toxic tort litigation.”<sup>153</sup> Such toxic tort remedies are preserved, not pre-empted nor expanded, by RCRA<sup>154</sup> and CERCLA<sup>155</sup> savings provisions. Often toxic tort litigation persists despite expenditures by the government and its defense contractors of hundreds of millions of dollars to clean up.<sup>156</sup> In these circumstances, naturally the plaintiffs would like to name the United States as a defendant. Contractors would also like the United States named as a defendant. The government obviously has a deep pocket. Joining the United States in the litigation also offers contractor defendants an opportunity to try to shift the blame.

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<sup>152</sup> Conrad G. Tuohey & Ferdinand V. Gonzalez, *Emotional Distress Issues Raised By The Release Of Toxic And Other Hazardous Materials*, 41 SANTA CLARA L. REV. 661, 664 (2001).

<sup>153</sup> *Id.*

<sup>154</sup> 42 U.S.C. § 6972(f) (2002) provides: “Nothing in this section shall restrict any right which any person (or class of persons) may have under any other statute or common law. . . .”

<sup>155</sup> 42 U.S.C. § 9659(h) (2002) states, “This chapter does not affect or otherwise impair the rights of any person under Federal, State, or common law, except [timing of review-- § 9613(h)] . . . or as otherwise provided in section 9658.” 42 U.S.C. § 9658 (2002) extends the statute of limitations for filing personal injury or property damage claims due to hazardous contaminant releases to the later of the State statute of limitations or the “federally required commencement date.” The substantive state law is not affected. *Id.*

<sup>156</sup> For example, toxic tort lawsuits against Lockheed lingered for six years before being settled, even after \$265 million of CERCLA expenses had been incurred. Carolyn Whetzel, *Department Of Justice To Pay Portion Of Cleanup At Lockheed Plant In California*, 73 FED. CONT. REP. 4 at 119, Jan. 25, 2000 (government agreed to reimburse Lockheed for between \$150 to \$200 million of the cost to clean up its Burbank California facility, formerly Air Force Plant 14). The last of the 3000 toxic tort suits was settled in April, 2002. Helen Gao, *Lockheed Martin Settles Pollution Case with Burbank, Calif., Residents*, LOS ANGELES DAILY NEWS, Apr. 17, 2002.

However, “The United States, as sovereign, ‘is immune from suit save as it consents to be sued . . . and the terms of its consent to be sued in any court define that court’s jurisdiction to entertain the suit.’”<sup>157</sup> RCRA and CERCLA waivers of sovereign immunity do not extend to injuries due to exposure to toxic contamination.<sup>158</sup> Thus, the ability to sue the United States for toxic torts, if at all, must be by virtue of a separate waiver of sovereign immunity.

**a) Federal Tort Claims Act (FTCA) Waiver of Sovereign Immunity**

The Federal Tort Claims Act (FTCA), which governs tort suits against the federal government, is a limited waiver of sovereign immunity.<sup>159</sup> Under the FTCA, victims of government negligence have recovered through the claims process or court action for numerous traditional tort actions (slip and fall cases, accidents caused by government employees or government vehicles, medical malpractice, etc.). The FTCA, however, specifically declines to waive sovereign immunity as to certain tort claims.<sup>160</sup> As explained below, it is particularly difficult to assert claims against the United States for pollution caused by its contractors. If a plaintiff’s claims fall outside the FTCA’s limited

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<sup>157</sup> *United States v. Testan*, 424 U.S. 392, 399 (1976) (quoting *United States v. Sherwood*, 312 U.S. 584, 586 (1941)).

<sup>158</sup> The only damages specifically authorized by CERCLA are natural resource damages in actions brought by State or Federal trustees for these natural resources. 42 U.S.C. §§ 9607(a)(1-4)(C), 9611(b)(1) and (i), 9613 (f-g) (2002). *See also* *Daigle v. Shell Oil Co.*, 972 F.2d 1527, 1544-45 (10th Cir. 1992) (“both houses of Congress considered and rejected any provision for recovery of private damages unrelated to the cleanup effort.”). RCRA does not provide for recovery of cleanup costs. *See Meghrig v. KFC Western, Inc.*, *supra* note 87 and accompanying text.

<sup>159</sup> 28 U.S.C. § 1346(b) (2002).

<sup>160</sup> *United States v. S.A. Empresa de Viacao Aerea Rio Grandense (Varig Airlines)*, 467 U.S. 797, 808 (1984).

waiver of sovereign immunity, the courts must dismiss the action for lack of subject matter jurisdiction.<sup>161</sup>

#### **b) FTCA Limitations**

The “independent contractor” and “discretionary function” exceptions to the FTCA provide virtually bulletproof insulation to the federal government for tort claims associated with historic environmental harms. Additionally, the FTCA does not subject the United States to strict liability.<sup>162</sup> This is important since many modern-day environmental statutes are based upon strict liability. Under the FTCA, the law of the place where the action occurred governs tort actions against the United States.<sup>163</sup> Because courts lack subject matter jurisdiction when these exceptions apply, the government often prevails on summary judgment, leaving the contractors to defend such cases on their own.<sup>164</sup>

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<sup>161</sup> *Id.* See also *Magee v. United States*, 121 F.3d 1, 4 (1st Cir. 1997).

<sup>162</sup> *Laird v. Nelms*, 406 U.S. 797, 802-03 (1972).

<sup>163</sup> 28 U.S.C. § 1346(b)(1) (2002).

<sup>164</sup> “The discretionary function exception . . . shields the government from liability. . . . This Court, therefore, lacks subject matter jurisdiction to entertain plaintiffs’ tort claims against the United States arising from the conduct, and the United States is entitled to summary judgment as to those claims.” *Vallier v. Jet Propulsion Laboratory*, 120 F. Supp. 2d 887, 912 (C.D. Cal. 2000) *aff’d*, 2001 U.S. App. LEXIS 27120 (9th Cir. 2001) (unpublished opinion) [hereinafter JPL] (since no federal jurisdiction, claims remanded to Los Angeles County Superior Court). See also *OSI, Inc. v. United States*, 285 F.3d 947 (11th Cir. 2002) (affirming summary judgment of FTCA allegations and remanding for additional information concerning CERCLA and RCRA allegations).

### 1) Independent Contractor Exception

The FTCA only allows suits against the United States for negligent or wrongful acts or omissions of government employees.<sup>165</sup> A government employee, “*does not include any contractor with the United States.*”<sup>166</sup>

A contractor is treated as an employee only when the federal government has the power to “control the detailed physical performance of the contractor.”<sup>167</sup> The standard is met only when “its day-to-day operations are supervised by the Federal Government.”<sup>168</sup> This test sounds hauntingly familiar to the demanding “actual control” test to prove operator or arranger liability established in *Bestfoods*. The mere fact that a contractor was producing materials for the national defense does not meet this test. Like *Bestfoods*, this test also requires actual control over the contractor’s waste disposal activities.<sup>169</sup>

Plaintiffs in *Vallier v. Jet Propulsion Lab.* [hereinafter *JPL*],<sup>170</sup> tried to convince the U.S. Court of Appeals for the Ninth Circuit to replace the day-to-day control test with a “right to control” standard.<sup>171</sup> In essence, the plaintiffs wanted the government to be

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<sup>165</sup> 28 U.S.C. § 1346(b) (2002).

<sup>166</sup> *Id.* (emphasis added).

<sup>167</sup> *Logue v. United States*, 412 U.S. 521, 528 (1973).

<sup>168</sup> *United States v. Orleans*, 425 U.S. 807, 815-16 (1976).

<sup>169</sup> *See Heinrich ex rel. Heinrich v. Sweet*, 83 F. Supp. 2d 214 (D.Mass. 2000). “The issue is not whether [Mass General] and MIT were independent contractors as to all of their activities, but whether as to the particular portion of their conduct which is the subject of this litigation they were functioning as independent contractors.”

<sup>170</sup> *JPL*, *supra* note 164.

<sup>171</sup> *Id.*

vicariously liable whenever it could have prevented the contractor's harmful practices. Although such an approach might sound just and reasonable, when dealing with issues of sovereign immunity, the courts will not extend jurisdiction in the interest of equity.

*JPL* involved a tort action by neighbors who claimed that they were harmed by JPL's release of toxic chemicals into the air, soil, and groundwater from 1940-1969.<sup>172</sup> Despite uncontested evidence that the government designed and supervised construction of JPL's waste facilities, the court found the United States, "did not exercise day-to-day control over waste disposal operations."<sup>173</sup> Sovereign immunity barred joining the United States in the suit because the contractor was independent. While the outcome hardly seems fair to JPL, the solution lies with Congress, not the courts.

Plaintiffs have attempted to circumvent the independent contractor exception by shifting the focus away from the contractor's actions to the government's failures to act. They have alleged failure to adequately supervise the contractor or failure to warn about the contractor's hazardous activities. At GOCO or federal facilities they have also sought similar relief against the U.S. as the landowner. The government has defended such allegations by asserting that because the actions challenged were discretionary, they were also beyond the scope of FTCA liability.

## **2) Discretionary Function Exception**

Under the discretionary function exception, Congress declined to waive sovereign immunity over, "[a]ny claim based upon the exercise or performance or the failure to

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<sup>172</sup> *Id.*

<sup>173</sup> *Id.* See also *Harper v. Lockheed Martin Energy Systems, Inc.*, 73 F. Supp. 2d 917 (E.D. Tenn. 1999) (despite ownership and pervasive regulation of toxic incinerator, court found U.S. did not engage in supervision over day-to-day operations of the contractor).

exercise or perform a discretionary function . . . whether *or not the discretion involved be abused*.”<sup>174</sup> The Supreme Court has established a two-part test for determining the applicability of the discretionary function exception [hereinafter “*Berkovitz test*”].<sup>175</sup> First, the allegedly negligent act or failure to act must not have been constrained by a mandatory and specific statute, regulation, or policy prescribing a course of action for an employee to follow.<sup>176</sup> Second, where the challenged conduct was not so constrained, the discretionary function exception applies so long as the decision or activity is grounded in social, economic, or political policy.<sup>177</sup> The government has enjoyed the same immunity whether it acts directly or through its contractors.

Environmental decisions frequently involve “judgment as to the balancing of many choices, including specifically the trade-off between greater safety and greater combat effectiveness.”<sup>178</sup> For this reason, courts have almost universally ruled that the full gamut of environmental decisions involve social, economic, or public policy

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<sup>174</sup> 28 U.S.C. § 2680(a) (2002) (emphasis added). A number of excellent articles describe the discretionary function exception. See e.g., Steven L. Schooner, *The FTCA Discretionary Function Exception Nullifies \$ 25 Million Malpractice Judgment Against the DCAA: A Sigh of Relief Concludes the DIVAD Contract Saga*, 1999 ARMY LAW. 17; Joshua I. Schwartz, *Liability for Sovereign Acts: Congruence and Exceptionalism in Government Contracts Law*, 64 GEO. WASH. L. REV. 633 (1996).

<sup>175</sup> *Berkovitz v. United States*, 486 U.S. 531, 536 (1988). See also *United States v. Gaubert*, 499 U.S. 315, 323 (1991).

<sup>176</sup> *Gaubert*, *id.* at 322; *Berkovitz*, *id.* at 536.

<sup>177</sup> *Gaubert*, *id.* at 322-23; *Berkovitz*, *id.* at 536-37.

<sup>178</sup> *Boyle v. United Technologies Corp.*, 487 U.S. 500, 511 (1988).



concerns under the second prong of the *Berkovitz* test.<sup>179</sup> These policy considerations form the justification for refusing to grant relief for discretionary acts (or omissions) that might otherwise be grounds for tort liability (failure to maintain fit premises, failure to warn, etc.). The government's decision to contract out waste disposal has specifically been held to be discretionary.<sup>180</sup>

Therefore, unless the government violated a mandatory and specific law or government policy, tradeoffs between mission impact and environmental impact are shielded by the discretionary function exception to the FTCA.<sup>181</sup> Whether laws or regulations are "discretion-robbing" directives are subject to case-by-case analysis. In *JPL*, after holding the United States was not liable for acts of its independent contractor, the court next addressed whether the discretionary function exception immunized the government in its own right:

Plaintiffs make sweeping arguments that three federal statutes, *enacted years after* the FTCA, as well as various Executive Orders, required the government to comply with specific mandatory federal, state and local pollution regulations, thereby removing any governmental discretion. [N]one of these statutes, regulations or orders prevented the government from delegating compliance therewith to its contractor . . . . Moreover,

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<sup>179</sup> *Dalehite v. United States*, 346 U.S. 15 (1953) (claims arising from explosion of ammonium nitrate fertilizer awaiting export to devastated areas after World War II barred by discretionary function exception); *Sea-Land Services, Inc. v. United States*, 919 F.2d 888, 891-92 (3d Cir. 1990) (government's use of asbestos in its rapid World War II ship construction program was a matter susceptible to policy analysis); *JPL*, *supra* note 164 (claims based upon design choice barred by the discretionary function exception); *Domme v. United States*, 61 F.3d 787 (10th Cir. 1995) (DOE delegation of safety compliance to management and operations contractor was discretionary function).

<sup>180</sup> *Kirchmann v. United States*, 8 F.3d 1273, 1274 (8th Cir. 1993). *See also* *Williams v. United States*, 50 F.3d 299, 309-310 (4th Cir. 1995) (decision to hire an independent contractor "involves exercising judgment based on considerations of policy").

<sup>181</sup> *Berkovitz*, *supra* note 175, at 536.

*the supervision of a contractor, even if negligent, is a discretionary function.*<sup>182</sup>

Temporal considerations (as alluded to in *JPL*) are often critical in assessing whether the pollution predates the potentially relevant restrictions. Today's mandatory and specific environmental obligations simply did not exist in the 1960's and earlier when much of the contamination occurred. As the following examples demonstrate, hazardous waste disposal choices were largely discretionary.

In *Aragon*, for example, Air Force personnel washed down scientific aircraft that had flown through nuclear test areas with trichloroethylene (TCE) to remove any radioactive dust or particulate.<sup>183</sup> The highly toxic waste was dumped in open ditches on the ground where it contaminated the soil and eventually seeped into the groundwater.<sup>184</sup> Plaintiffs in *Aragon* advanced numerous arguments that alleged laws and regulations imposed mandatory and specific restrictions. The court addressed these arguments and struck them down one by one as either not mandatory or not specific.<sup>185</sup>

In *Andrews v. United States*, the Navy exercised its discretion to delegate responsibility for disposal of its hazardous waste to a private contractor; the contractor caused the waste to contaminate groundwater in a residential neighborhood, thereby

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<sup>182</sup> *JPL*, *supra* note 164 (emphasis added).

<sup>183</sup> *Aragon v. United States*, 146 F.3d 819 (10th Cir. 1998).

<sup>184</sup> *Id.*

<sup>185</sup> *Id.* at 822-826. Specifically, state laws were not mandatory for the federal government; Executive Orders 10014 and 11258 were mandatory but not specific; Air Force Manuals 85-14 and 88-11 were intended for guidance—allowing discretion; and, broad public nuisance statutes did not create specific, mandatory water quality standards.

damaging plaintiffs.<sup>186</sup> The Eleventh Circuit held, “the discretionary function exception shields the government from strict liability for the contractor's actions and from liability under a theory of negligent failure to supervise because the Navy was free to delegate its safety responsibilities when these events occurred.”<sup>187</sup>

### **c) Government Contractor Defense**

In some circumstances, a contractor can actually piggyback off the government’s discretionary function exception and cloak itself in the government’s immunity. This scenario is known as the government contractor (or military contractor) defense. The U.S. Supreme Court has stated that: “Where the government has directed a contractor to do the very thing that is the subject of the claim, we have recognized this as a special circumstance where the contractor may assert a defense.”<sup>188</sup>

The courts justified this defense nicely during Agent Orange litigation: “Subjecting military contractors to full tort liability would inject the judicial branch into political and military decisions that are beyond its constitutional authority and institutional competence.”<sup>189</sup> The same rationale justifies the government’s discretionary function exception to FTCA liability. “The defense shields military contractors from

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<sup>186</sup> *Andrews v. United States*, 121 F.3d 1430, 1442 (11th Cir. 1997). The Court noted, “Congress has since enacted federal environmental legislation mandating nondelegable responsibility for hazardous waste disposal on the part of those who generate it.”

<sup>187</sup> *Id.*

<sup>188</sup> *Corr. Servs. Corp. v. Malesko*, 122 S. Ct. 515, 523 at n.6 (2001), citing *Boyle v. United Technologies Corp.*, 487 U.S. 500, 511-512 (1988).

<sup>189</sup> *In re Agent Orange Prod. Liab. Litig.*, 818 F.2d 187, 191 (2d Cir. 1987) (summary judgement dismissing Agent Orange litigation based on government contractor defense).

liability in order to protect the discretionary function of military procurement.”<sup>190</sup> While the *government’s* discretionary function shield extends to decisions regarding pollution (as discussed above), the *contractor’s* ability to shield itself from pollution liability is less clear. The Agent Orange precedent is not exactly on point because it concerned the toxic affects of the military product itself (dioxin in Agent Orange) versus contamination stemming from the production process.

The landmark Supreme Court decision concerning the defense, *Boyle v. United States Technologies Corp.* [hereinafter *Boyle*], is a product liability case.<sup>191</sup> Under *Boyle*, the defendants must prove that: (1) the government approved reasonably precise specifications for the item; (2) the item conformed to those specifications; and (3) the contractor warned the government about the dangers from the use of the item that were known to the contractor but not to the government.<sup>192</sup>

The first two elements are arguably satisfied when the government directs a particular manner of waste disposal and the contractor complies. In a case such as *JPL*,<sup>193</sup> where the government, not the contractor, exercised discretion in selecting the design of the pollution discharge system, the contractor should be able to prevail on these first two elements. The third element is satisfied when either the contractor warns the government of the hazards or when the government is equally or more aware of the

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<sup>190</sup> *Miller v. Diamond Shamrock Co.*, 275 F.3d 414 (5th Cir. 2001), as revised Jan. 28, 2002, 2001 U.S. App. LEXIS 26020 (dismissing Agent Orange litigation on summary judgement based on government contractor defense).

<sup>191</sup> *Boyle v. United Technologies Corp.*, 487 U.S. 500, 511-512 (1988).

<sup>192</sup> *Id.* at 512.

<sup>193</sup> Discussed *supra* at note 164 and accompanying text.

dangers.<sup>194</sup> Unless the contractor has specialized knowledge of pollution risks that it fails to share, it should also satisfy this element.

While there are good arguments that *Boyle* should be extended under the right circumstances to shelter government contractors from toxic tort liability arising from releases,<sup>195</sup> only a few courts so far have been willing to make this leap.<sup>196</sup> In *Morgan v. Brush Wellman, Inc.*, the court allowed the government contractor defense to shield beryllium manufacturers from the toxic effects of beryllium exposure of the workers.<sup>197</sup> The Atomic Energy Commission (AEC) strictly controlled beryllium production. In addition to precise design specifications for the end product, the AEC also mandated safety procedures, warnings, and permissible exposure limits. Unlike the Agent Orange

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<sup>194</sup> Miller, *supra* note 190, at 422 (citations omitted).

<sup>195</sup> See e.g., Chris M. Amantea & Stephen C. Jones, *The Growth Of Environmental Issues In Government Contracting*, 43 AM. U.L. REV. 1585, (1994) (arguing defense is suitable for toxic torts but not cleanup liability); Robert T. Lee & Scott E. Slaughter, *Government Contractors and Environmental Litigation*, 51 FED. CONT. REP. 13 at 2138, 2139, Mar. 27, 1989 (contending that defense should be applicable where environmental injury occurs as result of contractor's compliance with discretionary decisions of federal officials). One writer has suggested that the government contractor defense may not be available to future government contractors due to the demise of The Defense Production Act (DPA), because the DPA allowed the government to force contractor production of wartime products. Susan Rousier, *Note And Comment: Hercules v. United States: Government Contractors Beware*, 19 WHITTIER L. REV. 215, 250 (1997) citing 50 U.S.C. §§ 2061-2066 and 2071. However, *Boyle* rests on the discretionary function exception to the FTCA, it does not even mention the Defense Production Act. Boyle, *supra* note 191.

<sup>196</sup> State laws may also afford a defense. See *Green v. ICI America, Inc.*, 362 F. Supp. 1263 (E.D.Tenn. 1973) (where plant was owned by and under substantial supervision and control of the Army and entire production of ammunition by the plant was intended for Government consumption: "Tennessee law leaves no doubt that the defendant is entitled to share the sovereign immunity of the United States.").

<sup>197</sup> The court described beryllium as "per molecule the most deadly substance known to mankind." *Morgan v. Brush Wellman, Inc.*, 165 F. Supp. 2d 704, 709 (E.D. Tenn. 2001).

cases, the caustic effects were incidental to production. In *Morgan*, the court found that the manufacturers met the *Boyle* test: "the AEC gave the defendants precise, secret specifications for beryllium . . . the specifications, particularly warning labels, were exactly complied with . . . [and] the government was aware of all of the dangers of beryllium known to the defendants."<sup>198</sup> The court explained that placing liability on the government suppliers would interfere with the government's ability to balance worker safety and the combat readiness of the United States.<sup>199</sup> It remains to be seen whether other courts will follow this lead.<sup>200</sup>

#### **IV. Other Indemnification Schemes**

The previous sections discussed the difficulties confronted by contractors trying to recover from the government under environmental laws or the Federal Tort Claims Act and showed one means whereby contractors might derivatively benefit from the government's immunity from toxic tort suits. Because of the vast sums of money at stake, contractors also have explored other means of relief. This section discusses alternatives to 85-804 indemnity that may augment or replace a contractor's need to recover under Public Law 85-804. The following section addresses 85-804's advantages.

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<sup>198</sup> *Id.* at 717.

<sup>199</sup> *Id.* at 718.

<sup>200</sup> *Cf.*, *Arness v. Boeing North Am. (BNA)*, 997 F. Supp. 1268, 1273 (C.D. Cal. 1998) (court did not find sufficient evidence of federal interest to justify removal to the federal court even though there was a colorable government contractor defense). "BNA has not demonstrated that the government exercised any control over BNA's ability to take safeguards to prevent the release of TCE." *Id.* The court found a significant distinction between injuries arising from production of a required item versus improper disposal of TCE since BNA was not acting under federal direction concerning release. *Id.* at 1275.

### **A. CERCLA Indemnification for Cleanup Contractors**

42 U.S.C. § 9607(e)(1) expressly governs indemnification. It states: “No indemnification, hold harmless, or similar agreement or conveyance shall be effective to transfer from [any PRP] to any other person the liability imposed under this section.” This straightforward sentence would be easy to apply if not for the subsequent confounding sentence: “Nothing in this subsection shall bar any agreement to insure, hold harmless, or indemnify a party to such agreement for any liability under this subsection.” The former provision forbids a transfer of liability while the latter makes it appear that CERCLA liability may be shifted. Courts interpret the first sentence to mean that CERCLA liability applies to a PRP notwithstanding any indemnification agreements; they interpret the second sentence to allow the indemnified party to later recover from the indemnitor.<sup>201</sup> Responsible parties can lawfully allocate CERCLA response costs among themselves while remaining jointly and severally liable for the entire cleanup.

CERCLA has one indemnity provision that grants relief from liability.<sup>202</sup> It provides relief only to “response action contractors” conducting a CERCLA cleanup pursuant to a written agreement and is subject to a number of limitations. (1) Coverage only applies when commercial insurance is unavailable. (2) Only contamination arising out of response activities is covered. (3) The decision to indemnify a cleanup contractor working for a PRP takes into account the PRP’s assets and resources. (4) Finally, no

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<sup>201</sup> See *Olin Corp. v. Yeargin Inc.*, 146 F.3d 398, 407 (6th Cir. 1998) (citations omitted) and *PMC v. Sherwin Williams*, 44 ERC 1934, 1939 (N.D. Ill. Sept 23, 1996) citing *Harley-Davidson, Inc. v. Minstar, Inc.*, 41 F.3d 341 (7th Cir. 1994) *cert. denied*, 115 S. Ct. 1401 (1995).

<sup>202</sup> 42 U.S.C. § 9619(c) (2002).

owner or operator of a RCRA-permitted facility may be indemnified with respect to that facility.<sup>203</sup> Most government contractors have substantial assets and resources and are probably operating RCRA-permitted facilities. Even if indemnity applied, it would only insulate the response contractor, not the PRP (who would remain liable for the underlying contamination). Because there is precious little relief within CERCLA itself, most contractors must look elsewhere for protection.

## **B. Cost-Reimbursement Contracts**

Cost-reimbursement type contracts permit contractors to reduce the risk of environmental liability. Cost-type contracts allow contractors to pass known costs that are allowable and allocable to the contract directly on to the government. Thus, these costs do not negatively impact the contractors' profits.<sup>204</sup> One disadvantage is that the government typically decides what type of contract it will issue and the preference is for firm fixed price (precisely because the government ordinarily wants the contractor to bear the risk of cost overruns).<sup>205</sup> Cost-type contracts can be difficult for both the contractor and the government to administer; especially when contracts are subject to the Cost Accounting Standards (CAS) or pricing actions require certified cost or pricing data.<sup>206</sup>

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<sup>203</sup> *Id.*

<sup>204</sup> Unforeseen costs will erode profit under an incentive fee arrangement.

<sup>205</sup> Contractors could respond to a draft request for proposals to suggest that the government change to a cost-type contract when environmental costs are unknown or uncertain.

<sup>206</sup> For an argument that administrative requirements pertaining to cost-type contracts are too cumbersome and unwieldy, see John Cibinic, Jr., "Cost-based" Contracting: *On the Way Out?* 12 THE NASH & CIBINIC REPORTER 11, ¶58, Nov. 1998 ("allowability and allocability of costs must be considered in virtually all aspects of contract administration").



Finally, recovery of environmental costs remains an unsettled area. Whether costs are “environmental costs” has been heavily debated and costs to restore the environment or pay for toxic tort injuries usually are incurred many years after the contracts that generated the waste have been completed.

GAO issued several reports in the early 1990’s analyzing inconsistencies among DoD agencies in payment of defense contractors for costs of environmental cleanup. GAO concluded that policies and practices among DoD agencies varied widely, “ranging from complete denial to full reimbursement.”<sup>207</sup> In 1992, the FAR council published a draft environmental cost principle, which attempted “to establish order out of the emerging chaos.”<sup>208</sup> The draft principle met with heavy criticism from industry, as there was little or no consensus on what needed to be done about the allowability of environmental costs.<sup>209</sup> Despite the considerable efforts to develop a universal environmental cost principle in the early 1990’s, nothing came to fruition.<sup>210</sup> Many opposed the notion of special environmental cost principles, arguing that they were

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<sup>207</sup> See, e.g., ENVIRONMENTAL CLEANUP: OBSERVATIONS ON CONSISTENCY OF REIMBURSEMENTS TO DOD CONTRACTORS, GAO/NSIAD-93-77, Oct. 1992; ENVIRONMENTAL CLEANUP: UNRESOLVED ISSUES IN REIMBURSEMENT TO DOD CONTRACTORS, GAO/T-NSIAD-93-12, May 1993.

<sup>208</sup> Scott P. Isaacson and Peter A. McDonald, *Environmental Cost of Government Contractors: Cutting the Gordian Knot*, 62 FED. CONT. REP. 22 at d17, Dec. 19, 1994, citing 57 FED. CONT. REP. 18 at 692, May 4, 1992.

<sup>209</sup> *Id.* at 2.

<sup>210</sup> Interview with Laura Smith, General Services Agency Representative to the Environmental Subcommittee of the FAR Council, Feb. 20, 2002.

unnecessary and merely added a layer of confusion to an already confusing scheme.<sup>211</sup>

Since no specific environmental cost principle was created, costs must be analyzed under the general cost principles to determine whether the government will pay these costs.<sup>212</sup>

To be reimbursed, such costs must be “allowable,” “allocable,” and “reasonable.”<sup>213</sup>

### **1. Allowability**

To be reimbursed, costs must be allowable. Allowability turns on whether a cost is reasonable in nature and amount, whether the cost is allocable to the contract in issue and whether the cost is expressly unallowable.<sup>214</sup>

Expressly unallowable costs must be separately identified and subtracted when certifying indirect costs incurred for final reconciliation of flexibly priced contracts.<sup>215</sup>

. Costs to pay environmental fines and penalties and the legal costs of defending or settling

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<sup>211</sup> Interview with Peter A. McDonald, attorney and Certified Public Accountant and author of numerous articles criticizing the proposed environmental cost principle (*see supra* note 208), Feb. 13, 2002. Mr. McDonald further indicated that government officials were ultimately convinced that these costs could be adequately addressed under the existing FAR scheme.

<sup>212</sup> By “costs” I refer to the out of pocket expenses to deal with specific contamination as opposed to the generic taxes on industry imposed to initially fund the Superfund. The latter are specifically allowable. FAR 31.205-41(a)(4). *But see* Rockwell Int’l Corp., ASBCA No. 46544, 96-1 BCA ¶ 28,057 (such taxes prior to 1991 held unallowable).

<sup>213</sup> The primary cost principles applicable to environmental costs are FAR Subsections: 31.201-2, Allowability; 31.201-3, Reasonableness; and 31.201-4, Allocability.

<sup>214</sup> *See* FAR 31.201-2.

<sup>215</sup> 10 U.S.C. § 2324(h)-(i) and 41 U.S.C. § 256(h)-(i) (2002) (knowing submission of proposal including expressly unallowable costs subjects violator to criminal and civil fraud remedies). *See also* FAR 31.110(b) (authorizing penalties); FAR 52.242-4 (must certify proposal “does not include any costs which are expressly unallowable”); and FAR 42.703-2(c)(2)(i) (failure to certify may result in final indirect cost rates being unilaterally established by the contracting officer after excluding unallowable costs).

such cases can be steep and often must be borne entirely by the contractor. Payment of fines and penalties are unallowable costs unless authorized in writing in advance of payment by the contracting officer or to comply with specific terms and conditions of the contract.<sup>216</sup> FAR 31.205-47 makes costs related to legal and other proceedings incurred in connection with actions brought by federal, state or local governments for violations of laws and regulations expressly unallowable. Other environmental costs are not expressly unallowable, so reimbursement is allowed when these costs are reasonable and allocable.

## **2. Reasonableness**

In order to be allowable, costs must be reasonable both in nature and amount. A cost is reasonable in nature if it reflects the type of costs that would be incurred by a prudent businessperson. A cost is reasonable in amount if it reflects the fair market value for services performed. Expenses in excess of the fair market value are not payable. Since costs are no longer presumed reasonable in amount merely because they have actually been incurred,<sup>217</sup> contractors must now prove they did not pay too much for cleanup services or to settle a tort claim. Where costs are high, contractors should expect heavy government audit interest.

The Defense Contract Audit Agency (DCAA) developed audit policies for environmental costs based upon the proposed FAR cost principle in the 1990's. While these audit policies lack the force and effect of law, they certainly govern the practices of DCAA auditors in deciding what costs DoD will pay. Accordingly, they are very useful

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<sup>216</sup> 10 U.S.C. § 2324(e)(1)(D) (2002) and 41 U.S.C. § 256 (e)(1)(D) (2002). *See also* FAR 31.205-15.

<sup>217</sup> FAR 31.201-3(a).

for defense contractors to know. Although a complete discussion of the audit manual guidance is beyond the scope of this thesis, a few highlights demonstrate that cost-type contracts are not a panacea for making contractors whole for environmental liabilities.<sup>218</sup>

If environmental cleanup costs were the result of contractor “wrongdoing” (violation of laws, regulations, orders or permits, or disregard of warnings for potential contamination), “the clean-up costs including any associated costs, such as legal costs would be unreasonable and thus unallowable.”<sup>219</sup> Deciding what constitutes wrongdoing may be no easy task as it depends on knowledge of how the contamination occurred.<sup>220</sup> Where there is no wrongdoing, auditors are instructed to ensure the contractor has not paid too much.<sup>221</sup> DCAA also instructs its auditors to negotiate advance agreements so the government can share in any future relief the contractors might receive through insurance or contribution recoveries from other PRPs.<sup>222</sup>

Recovery for toxic tort liability is even less promising. Third-party claims for health impairment, property damage, or property devaluation for residents or property owners near a contaminated site “arise from legal theories of tort and trespass, and losses from such claims would be unreasonable in nature for payment on a government

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<sup>218</sup> For a more detailed discussion, see Michael T. Janick, *Environmental Cost Issues*, 68 FED. CONT. REP. 8 at d47, Aug. 1997.

<sup>219</sup> Defense Contract Audit Agency Manual [hereinafter DCAAM] 7640.1, Vol. 1, § 7-2120.13 (Jan. 2002); <<http://web1.deskbook.osd.mil>>.

<sup>220</sup> *Id.* at § 7-2120.13(c).

<sup>221</sup> “Contractors should not be reimbursed for increased costs incurred in the clean-up of contamination which they should have avoided.” *Id.* at § 7-2120.5.

<sup>222</sup> See *id.* at §§ 7-2120.14-15.

contract.”<sup>223</sup> DCAA’s guidance says: “In the absence of a specific court finding of tort or trespass by the contractor, the facts of each case should be carefully examined to determine if any contractor payments are nonetheless based on those or other fault-based legal theories.” Considering many toxic tort recoveries are based on strict liability (liability without fault), contractors should zealously negotiate for reimbursement when they did not violate laws or regulations in force at the time of the pollution.

### **3. Allocability**

Costs must be allocable to be reimbursed. A cost is allocable if it is assignable or chargeable to one or more cost objectives (contracts) on the basis of relative benefits received or other equitable relationship.<sup>224</sup> Allocability of environmental costs is only briefly addressed in the DCAA audit manual. “Costs to clean up environmental contamination caused in prior years will generally be period costs allocated through a company’s G&A [general and administrative] expense pool.”<sup>225</sup> These costs “should be allocated to the segment(s) associated with the contamination for inclusion as part of the segment’s G&A cost.”<sup>226</sup> A segment is one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to the

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<sup>223</sup> *Id.* at § 7-2120.12 -- Fault-Based Liabilities to Third Parties.

<sup>224</sup> FAR 31.201-4.

<sup>225</sup> *Id.* at § 7-2120.6.

<sup>226</sup> *Id.*

home office; it is under independent management and is usually responsible for profit and loss.<sup>227</sup>

Spreading the costs as G&A seems infinitely preferable to trying to track cleanup costs to particular contracts through some mathematical fabrication linking costs of cleanup to pollution generated on every given production effort. However, any contract-based relief (indemnification, extraordinary relief, or insurance) must be subtracted from the costs allocable to the G&A pool to prevent double recovery.<sup>228</sup> The greatest risk to the contractor occurs if the DCAA auditor concludes there has been an over-allocation of environmental costs to government contracts. The auditor's first (and most probable) response would be to challenge the costs and allocation methodology, but if the circumstances were bad enough (i.e., the auditor suspected a pattern of improper billing), it could result in a fraud referral.<sup>229</sup>

This section covered obstacles to reimbursement of environmental costs on cost-type contracts. The following sections discuss particular contract clauses that might allow the contractors to recoup environmental costs. As discussed below, clauses in the contract may allow recovery, whereas implied indemnity agreements are inadequate.

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<sup>227</sup> See FAR 31.001 and Cost Accounting Standard 403-30, 48 C.F.R. § 9904.403-30 (2002). Where the segment generating the pollution has closed, circumstances are considered on a case-by-case basis, "to determine if the costs incurred for the closed segment should be directly allocated to other segments, be allocated as residual home office costs, or be treated as an adjustment of costs associated with the closing of the segment." DCAAM at § 7-2120.7.

<sup>228</sup> See FAR 31.202(a), FAR 31.203(a), and Cost Accounting Standard 402-20, 48 C.F.R. § 9904.402-20 (2002).

<sup>229</sup> Interview of Peter A. McDonald, *supra* note 211.

### C. Other Special Indemnification Clauses

Contractors have tried unsuccessfully to convince the courts they are equitably entitled to implied indemnification from the government for toxic tort liability. In *Hercules, Inc. v. United States*, the Supreme Court ruled against implied agreements to indemnify defense contractors for this contingent liability.<sup>230</sup> The court reasoned that waivers of sovereign immunity are strictly construed and the law creates detailed procedures for seeking indemnification.<sup>231</sup> “These statutes, set out in meticulous detail and each supported by a panoply of implementing regulations, would be entirely unnecessary if an implied agreement to indemnify could arise from the circumstances of contracting.”<sup>232</sup> The Anti-Deficiency Act<sup>233</sup> also militated against the notion that the contracting officer could enter into such open-ended agreements with no funds obligated

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<sup>230</sup> *Hercules, Inc. v. United States*, 516 U.S. 417, 426 (1996). The *Hercules* Court concluded:

The Government required Thompson to produce under authority of the DPA [Defense Production Act of 1950, 64 Stat. 798, as amended 50 U.S.C. App. § 2061 *et seq.*] and threat of civil and criminal fines, imposed detailed specifications, had superior knowledge of the hazards, and, to a measurable extent, seized Thompson's processing facilities. Under these conditions, petitioner contends, the contract must be read to include an implied agreement to protect the contractor and indemnify its losses. We cannot agree.

<sup>231</sup> *Id.* at 516 U.S. 426-429. The *Hercules* court also held that the Defense Production Act afforded *immunity* to contractors for consequences arising out of covered contracts, not *indemnity*.

<sup>232</sup> *Id.* at 516 U.S. 429, citing 50 U.S.C. §§ 1431-1435 (Pub. L. No. 85-804), 10 U.S.C. § 2354 (research and development indemnification), and 42 U.S.C. § 2210 (Price-Anderson indemnification for nuclear incidents); Anti-Deficiency Act, 31 U.S.C. § 1341 (2002).

<sup>233</sup> 31 U.S.C. § 1341 (2002).

to support those agreements.<sup>234</sup> Consequently, contractors must rely upon express indemnity clauses. The following sections briefly discuss other express indemnification clauses to highlight why recovery under those clauses may be inadequate and to distinguish them from the INDEMNIFICATION UNDER PUBLIC LAW 85-804 clause.

## **1. WWII Era Indemnification Clauses**

Facilities contracts during WWII contained broad agreements by the government to “indemnify and hold the contractor harmless against any loss, expense, damage or liability of any kind whatsoever arising out of or in conjunction with the performance of work under this contract.”<sup>235</sup> These sweeping clauses were subject only to corporate officers exercising due care and acting in good faith.<sup>236</sup> Despite the breadth of these clauses, to date they have afforded little relief.

Commentators suggest several sources of uncertainties about whether WWII indemnity clauses afford relief for environmental damages. When the war ended, Congress desired finality as it terminated these contracts.<sup>237</sup> Releases were signed under

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<sup>234</sup> *Id.* at 516 U.S. 427-28.

<sup>235</sup> Mark J. Connor, *Government Owned-Contractor Operated Munitions Facilities: Are They Appropriate in the Age of Strict Environmental Compliance and Liability?* 131 MIL. L. REV. 1, 4 (1991) (clause included in St. Louis Army Ammunition Plant Contract). *See also* Randall J. Bunn, *Contractor Recovery for Current Environmental Cleanup Costs Under World War II-Era Government Contract Indemnification Clauses*, 41 A.F. L. REV. 163, 203 (1997) (methodically analyzing similar clauses) and Kenneth M. Theurer, *Sharing the Burden: Allocating the Risk of CERCLA Cleanup Costs*, 50 A.F. L. REV. 65, 69-72 (2001) (discussing details of three WWII contracts with similar indemnity clauses).

<sup>236</sup> *Id.*

<sup>237</sup> Theurer, *supra* note 235, at 128.



the Contract Settlements Act of 1944.<sup>238</sup> Cost allowability is questionable.<sup>239</sup> Unlimited liabilities violate the Anti-Deficiency Act.<sup>240</sup> It is difficult to construe the parties' intent to allocate all future environmental risks to the government.<sup>241</sup> Finally, environmental obligations arose decades after performance of the contract.<sup>242</sup>

## **2. Facilities Clauses**

### **a) INSURANCE-LIABILITY TO THIRD PERSONS**

FAR 52.228-7 allows the contractor to be compensated for certain liabilities arising out of performance of the contract and resulting in bodily injury or death or damage to the property of third parties. A similar clause has been used in most cost reimbursement contracts and many facilities contracts over the decades.<sup>243</sup>

Originally, these insurance liability clauses subjected the government to open-ended liability.<sup>244</sup> Accordingly, the GAO struck these clauses down because they

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<sup>238</sup> 41 U.S.C. § 120. See Theurer, *supra* note 235, at 127.

<sup>239</sup> See Bunn, *supra* note 235, at 227-30 for detailed cost allowability analysis and a comparison with liability for third-party asbestos claims.

<sup>240</sup> *Id.* at 218-226. See also Philip M. Kannan, *The Compensation Dimension of CERCLA: Recovering Unpaid Contract Costs*, 30 U. MEM. L. REV. 29, 31 (1999).

<sup>241</sup> Bunn, *supra* note 235, at 233-34.

<sup>242</sup> *Id.*

<sup>243</sup> FAR 28.311-1 makes the clause mandatory in present cost-reimbursement contracts. "Prior to the FAR [this clause was] standard in virtually all facilities contracts." Connor, *supra*, note 235, at 11.

<sup>244</sup> See, for example, Defense Acquisition Regulation 7-702.22.

violated the Anti-Deficiency Act.<sup>245</sup> The FAR clause was changed to make payment “subject to the availability of appropriated funds at the time a contingency occurs.”<sup>246</sup> Since the liability is no longer open-ended, the modern clause should survive Anti-Deficiency Act challenges (so long as funds are available). Nevertheless, this clause must also be read in conjunction with other contract clauses, discussed below, which can be problematic.

#### **b) GOVERNMENT PROPERTY**

In apparent contradiction to the aforementioned clause, the GOVERNMENT PROPERTY clause requires the contractor to indemnify and hold harmless the government against claims for injuries to persons or damages to contractor property arising from the contractor’s possession of government property.<sup>247</sup> Before promulgation of the FAR, this clause for indemnification of the government expressly excluded liability addressed under the INSURANCE-LIABILITY TO THIRD PERSONS clause. In those days, the two clauses could be harmonized. Today, reading the clauses together creates some question about third-party liability, because the clauses tend to cancel each other out. The GOVERNMENT PROPERTY clause absolves the government from liability stemming from the use of government property. Government property is used extensively when the contractor is operating a government facility. Injuries to third

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<sup>245</sup> *In re* Assumption by Gov’t of Contractor Liab. To Third-Persons, B-201072, 82-1 CPD ¶ 406, *aff’d on reconsideration*, 62 Comp. Gen 361, 364-65, 83-1 CPD ¶ 501.

<sup>246</sup> FAR 52.228-7(d). It further states, “Nothing in this contract shall be construed as implying that the Congress will, at a later date, appropriate funds sufficient to meet deficiencies.”

<sup>247</sup> FAR 52.245-11(i).

persons could commonly arise from the use of government property. Under the INSURANCE-LIABILITY TO THIRD PERSONS clause, the government should indemnify the contractor for these costs; at the same time, under the GOVERNMENT PROPERTY clause, the contractor should indemnify the government.

### **c) LIABILITY FOR FACILITIES**

The LIABILITY FOR FACILITIES clause applicable to GOCOs adds more confusion. It provides contractors “shall not be liable for any loss or destruction of, or damage to, the facilities or for expenses incidental to such loss, destruction or damage.”<sup>248</sup> It is not hard to imagine that including all three of these clauses into the same facilities contract creates confusion about who is indemnifying whom and for what.

### **3. Price-Anderson Relief for Nuclear Accidents**

Prior to 1988, the DOE could indemnify its contractors for “extraordinary nuclear occurrences” under Public Law 85-804 or the Atomic Energy Act.<sup>249</sup> An extraordinary nuclear occurrence is “any event causing a discharge or dispersal of source, special nuclear, or byproduct material . . . offsite, or causing radiation levels offsite, which . . . has resulted or will probably result in *substantial damages to persons offsite or property offsite.*”<sup>250</sup>

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<sup>248</sup> FAR 52.245-8. Caveats apply for insured losses, willful misconduct of supervisory personnel, and losses “[f]or which the contractor is otherwise responsible under the express terms of this contract.”

<sup>249</sup> An Act to Amend the Atomic Energy Act of 1954 (later referred to as Price-Anderson Act (1957)), Pub. L. No. 85-256, 71 Stat. 576 (1957).

<sup>250</sup> 42 U.S.C. § 2014(j) (2002) (emphasis added).

The Price-Anderson Amendments Act of 1988 made significant changes to the indemnification scheme for nuclear accidents.<sup>251</sup> First, it made indemnification mandatory (versus discretionary) for all DOE contractors generating or disposing nuclear waste. Second, it made Price-Anderson relief the exclusive form of indemnification for nuclear accidents (to the exclusion of Public Law 85-804 relief):

Beginning 60 days after the date of enactment of the Price-Anderson Amendments Act of 1988, agreements of indemnification under subparagraph (A) shall be the exclusive means of indemnification for public liability arising from activities described in such subparagraph, including activities conducted under a contract that contains an indemnification clause under Public Law 85-804 entered into between August 1, 1987, and the date of enactment of the Price-Anderson Amendments Act of 1988.<sup>252</sup>

Perhaps most importantly, it greatly expanded the scope of events enabling indemnification from “catastrophic” events to “nuclear incidents.” The Act defined a nuclear incident as “*any occurrence, including an extraordinary nuclear occurrence . . . causing . . . bodily injury, sickness, disease, or death, or loss of or damage to property, or loss of use of property, arising out of or resulting from the radioactive, toxic, explosive, or other hazardous properties of source, special nuclear, or byproduct material.*”<sup>253</sup>

Nuclear incidents can occur in the course of construction, possession, or operation of any nuclear facility, transportation of nuclear material, or for nuclear waste activities.<sup>254</sup>

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<sup>251</sup> Price-Anderson Amendments Act of 1988, Pub. L. No. 100-408, 102 Stat. 1066 (1988) (codified as amended at 42 U.S.C. §§ 2014, 2210, 2273 and 2282a (2002)).

<sup>252</sup> 42 U.S.C. § 2210(d)(1)(B)(i)(I) (2002).

<sup>253</sup> 42 U.S.C. § 2014(q) (2002).

<sup>254</sup> *Id.*

Nuclear waste activities include research and development on spent nuclear fuel and storage, handling, transportation, treatment, or disposal of radioactive waste.<sup>255</sup>

The amended Price-Anderson scheme features: (1) broad coverage<sup>256</sup> for all DOE contractual activities that might result in a nuclear incident in the United States; (2) full indemnification for all legal liability up to the statutory limit (currently \$8.96 billion);<sup>257</sup> and (3) indemnification is not subject to the availability of funds.<sup>258</sup> Also, punitive damages are forbidden.<sup>259</sup>

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<sup>255</sup> 42 U.S.C. § 2014(ff) (2002).

<sup>256</sup> In the hearings on the original Act,

the question of protecting the public was raised where some unusual incident, such as negligence in maintaining an airplane motor, should cause an airplane to crash into a reactor and thereby cause damage to the public. Under this bill, the public is protected and the airplane company can also take advantage of the indemnification and other proceedings.

S. Rep. No. 296, 85th Cong., 1st. Sess. (1957), U.S. Code Cong. & Ad. News 1803, 1818.

<sup>257</sup> 62 Fed. Reg. 68,272-75 (1997). If the version of reauthorization passed by the senate becomes law, this amount would increase to \$10 billion and thereafter be adjusted for inflation. Price-Anderson Act Amendments of 2002, § 503(a)(2)(B), H.R. 4, 107th Cong. (2002) (as passed and amended by the Senate Apr. 25, 2002).

<sup>258</sup> The Atomic Energy Act, as amended, waives the provisions of the Anti-Deficiency Act with respect to indemnity agreements. It permits an obligation in advance of appropriations to provide whatever funds are needed to satisfy a Price-Anderson indemnification. 42 U.S.C. § 2210(j) (2002). Congress will, “take whatever action is deemed necessary (including approval of appropriate compensation plans and appropriation of funds) to provide full and prompt compensation to the public for all public liability claims” if damage from a nuclear incident exceeds the statutory limit on aggregate public liability. 42 U.S.C. § 2210(e)(2) (2002). Moreover, the President must submit a compensation plan to Congress that “provide[s] for full and prompt compensation for all valid claims” no later than 90 days after the determination by a court that the liability limit may be exceeded. 42 U.S.C. § 2210(l) (2002).

<sup>259</sup> 42 U.S.C. § 2210(s) (2002).

Indemnity extends beyond the contractor to all “persons indemnified” under the Act. “Person indemnified” is defined as the person with whom an indemnity agreement is executed, (i.e., a DOE contractor), “and any other person who may be liable for public liability” for a nuclear incident.<sup>260</sup> Public liability is defined as “any legal liability arising out of or resulting from a nuclear incident or precautionary evacuation . . . .”<sup>261</sup>

Protection extends to persons who have no legal relationship to DOE, who may be liable for a nuclear incident within the United States arising under a DOE contract. Thus, a subcontractor, a supplier, a shipper, or other third party is covered even if it is not party to the indemnity agreement between DOE and the contractor.<sup>262</sup>

The 1988 Amendments also added new sections to the Atomic Energy Act (AEA) that established a system of civil<sup>263</sup> and criminal<sup>264</sup> penalties for violation of DOE nuclear

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<sup>260</sup> 42 U.S.C. § 2014(t) (2002).

<sup>261</sup> 42 U.S.C. §§ 2014(w) (2002). Legal liability is not defined, but the definition of “public liability action” indicates clearly that state tort law determines what legal liabilities are covered. 42 U.S.C. § 2014(hh) (2002). Such liability includes legal costs “incurred by a plaintiff or a defendant in initiating, prosecuting, investigating, settling, or defending claims or suits for damage arising under such section.” 42 U.S.C. § 2014(jj) (2002).

<sup>262</sup> S. Rep. No. 1677, 87th Cong., 2d Sess. (1962), U.S. Code Cong. & Ad. News 2207, 2215-16.

<sup>263</sup> Any contractor, subcontractor or supplier covered by the DOE Price-Anderson indemnification “who violates . . . any applicable rule, regulation or order related to nuclear safety . . . shall be subject to a civil penalty of not to exceed \$100,000 for each such violation [and] . . . each day of such violation shall constitute a separate violation.” 42 U.S.C. § 2282a(a) (2002). The \$100,000 amount has been adjusted for inflation as required by the Debt Collection Act of 1996 and now is \$110,000. 10 C.F.R. § 820.81 (2001). This section of the C.F.R. also contains a lengthy appendix with DOE’s policies and procedures for enforcement of civil penalties.

safety requirements by contractors, subcontractors, and suppliers covered by Price-Anderson indemnification. The penalties were intended to improve accountability of indemnified contractors, subcontractors, and suppliers without affecting the operation of the Price-Anderson system.<sup>265</sup> Thus, the imposition of penalties does not compromise or undermine the coverage of any indemnified person.

The Price-Anderson system has been extended and amended approximately every ten years. Authority to grant the DOE Price-Anderson indemnification is presently set to expire August 1, 2002; however, pending legislation would continue this scheme indefinitely.<sup>266</sup> If not extended, DOE could return to 85-804 indemnification for nuclear incidents. If extended, Price-Anderson will continue to play the dominant role regarding nuclear risks, especially nuclear waste activities, where, by statute, DOE is responsible for such disposal.<sup>267</sup>

#### **4. Indemnification for Research & Development (R&D) Contracts**

The DoD and the armed services can indemnify risky R&D contracts pursuant to 10 U.S.C. § 2354. When the Secretary of the department concerned approves, the United

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<sup>264</sup> Criminal penalty provisions apply to knowing and willful violations by officers and employees of contractors, subcontractors and suppliers covered by the 42 U.S.C. § 2273(c) (2002).

<sup>265</sup> 62 Fed. Reg. 68,272-78 (1997).

<sup>266</sup> Proposed Price-Anderson Act Amendments of 2002, § 502(b), H.R. 4, 107th Cong. (2002) (as passed and amended by the Senate Apr. 26, 2002). The House version would extend the Act to 2017. H.R. 2983 107th Cong. (Nov. 20, 2001).

<sup>267</sup> 42 U.S.C. § 10222 (2002).

States may indemnify an R&D contractor against injury or damage to the contractor or third parties arising from unusually hazardous risks identified in the contract.<sup>268</sup>

These clauses are limited to liability arising out of the direct performance of the contract and to the extent not compensated by insurance or otherwise.<sup>269</sup> They have been included routinely in defense-related contracts associated with nuclear weapons research and development. A typical clause affording 10 U.S.C. § 2354 indemnification defines unusually hazardous risk as:

*risks arising out of or resulting from the radioactive, toxic, explosive, or other hazardous properties of source, special nuclear, byproduct or radioactive materials, regardless of whether the harm caused by such risks takes place before or after the delivery to the government of equipment or materials under this contract.*<sup>270</sup>

The scope of the risks covered sounds strikingly like the “nuclear incident” risks insured under Price-Anderson. The implementation, however, mirrors 85-804. Like Public Law 85-804, indemnification is discretionary and the scope of the indemnity is governed by how “unusually hazardous risks” are defined in the contract. Like Public

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<sup>268</sup> 10 U.S.C. § 2354 (2002) allows indemnity for:

- (1) Claims (including reasonable expenses of litigation or settlement) by third persons, including employees of the contractor, for death, bodily injury, or loss of or damage to property, from a risk that the contract defines as unusually hazardous.
- (2) Loss of or damage to property of the contractor from a risk that the contract defines as unusually hazardous.

<sup>269</sup> *Id.*

<sup>270</sup> 10 U.S.C. § 2354 indemnity clause from Contract No. AF33 (600)-38946, Research and Development for Design of Nuclear Powered Aircraft (excerpt from materials on file in the office of the Secretary of the Air Force, General Counsel for Acquisition). Emphasis added to illustrate identical language to nuclear risk indemnity under Price-Anderson Amendment Act of 1988 (see *supra* note 251 and associated text).



Law 85-804, the relief also extends past the performance period of the contract and creates a statutory exception to the Anti-Deficiency Act.<sup>271</sup> 10 U.S.C. § 2354 affords broader protection than 85-804 since there is no wartime or national emergency requirement and there is no requirement for a finding that indemnification facilitates the national defense.<sup>272</sup> While the relief afforded is generous, the application is limited to DoD research and development contracts. When applicable, indemnification under 10 U.S.C. § 2354 pre-empts the use of Public Law 85-804 indemnification.<sup>273</sup> The amount of relief granted under 10 U.S.C. § 2354 is statutorily limited to amounts determined by the service Secretary (or designee) to be “just and reasonable.”<sup>274</sup>

## **V. Advantages of Public Law 85-804 for Contractors**

### **A. Relief Survives Contract Completion**

To the extent that environmental liability may arise many years after a contamination incident, contractors might find 85-804 relief attractive because the contracts that generated the pollution could be long since completed. Most contract remedies are foreclosed after release and final payment of a completed contract (or

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<sup>271</sup> “Upon approval by the Secretary concerned, payments . . . may be made from—

- (1) funds obligated for the performance of the contract concerned;
- (2) funds available for research or development, or both, and not otherwise obligated; or
- (3) funds appropriated for those payments.” 10 U.S.C. § 2354(d) (2002).

<sup>272</sup> 10 U.S.C. § 2354(c) (2002).

<sup>273</sup> DFARS 250.403-70.

<sup>274</sup> The INDEMNIFICATION UNDER PUBLIC LAW 85-804 clause imposes a similar “just and reasonable” cap as a contract term. FAR 50.250-1(f).

termination of a contract that was never completed).<sup>275</sup> Environmental liability, however, often arises many years after contract completion. Although the window of opportunity for ordinary contract remedies may have vanished, the potential for 85-804 relief remains. The INDEMNIFICATION UNDER PUBLIC LAW 85-804 clause states, "The rights and obligations of the parties under this clause shall survive this contract's termination, expiration, or completion." Contractors may also apply any time for extraordinary contractual relief to a contract adjustment board.<sup>276</sup>

### **B. Some Relief from the Anti-Deficiency Act**

Without special statutory authority, attempts to indemnify contractors that place no limits on the amount of indemnification are illegal under the Anti-Deficiency Act.<sup>277</sup>

The Anti-Deficiency Act (ADA) provides:

An officer or employee of the United States Government . . . may not --  
(A) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation;

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<sup>275</sup> However, third-party liability is reserved consistent with the statute of limitations:

Claims together with reasonable expenses incidental thereto, based upon the liabilities of the Contractor to third parties arising out of the performance of said contract, which are not known to the Contractor on the date of the execution of this release and of which the Contractor gives notice not more than six (6) years after the date of the release or the date of any notice to the Contractor that the Government is prepared to make final payment, whichever is shorter.

Contractor's Release, Contract No. F33657-72-C-0811 (on file with author).

<sup>276</sup> As time passes relief to a contractor may no longer "facilitate the national defense." See Allied Signal, Inc., Docket No. 85-804-19, 1996 DOT BCA LEXIS 23, Sept. 20, 1996 ("The fact that AMEX is no longer an operating entity militates heavily against a determination that granting the relief requested would facilitate the national defense.").

<sup>277</sup> Hercules, 516 U.S. 417, 428 n.10 (quoting *In re* Assumption by Gov't of Contractor Liab. To Third-Persons—Reconsideration, 62 Comp. Gen. 361, 364-65 (1983)).

(B) involve [the] government in a contract or obligation for the payment of money before an appropriation is made unless authorized by law.<sup>278</sup>

Public Law 85-804 allows relief from the ADA but this relief is currently tempered by the language “within the limits of the amounts appropriated and the contract authorization provided therefor.”<sup>279</sup> The limitation does not apply to claims or losses arising out of authorized indemnity provisions “from risks that the contract defines as unusually hazardous or nuclear in nature.”<sup>280</sup> In short, the ADA is only waived in accordance with properly approved indemnity clauses.

### **C. Public Law 85-804 Allows Recovery of Legal Expenses**

The opportunity to recover legal fees is a huge incentive for seeking 85-804 indemnification. Environmental litigation is inherently lengthy, complex and expensive. Scientific testimony from expert witnesses is required to prove causation and injury. Specialized legal counsel must usually be retained and the number of parties to the litigation is often very large, complicating discovery, settlement efforts, and litigation.

85-804 relief extends to “claims (including reasonable expenses of litigation and settlement).”<sup>281</sup> The real question then becomes what legal expenses are reasonable. The INDEMNIFICATION UNDER PUBLIC LAW 85-804 clause requires notice to the government of all actions or losses reasonably expected to result in indemnification, an

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<sup>278</sup> 31 U.S.C. § 1341 (2002).

<sup>279</sup> Exec. Order No. 10789, paragraph 1, 23 Fed. Reg. 8,897 (1958), *reprinted as amended in* 50 U.S.C. § 1431 (2002).

<sup>280</sup> *Id.* at paragraph 1A.

<sup>281</sup> *Id.* at paragraph 1A(b)(1). The INDEMNIFICATION UNDER PUBLIC LAW 85-804 clause, also makes this provision a term of the contract. FAR 52.250-1.

opportunity for the government to direct, control or assist in settling or defending all such claims, and compliance with government directions. Failure to comply could make some or all of the contractor's litigation or settlement expenses unreasonable.

## **VI. Limitations of Public Law 85-804 Relief for Environmental Liability**

While the benefits of indemnification under Public Law 85-804 are tremendous, the use of the clause is strictly circumscribed to "unusually hazardous or nuclear" risks. Since inclusion is discretionary, contractors may face disparate treatment among agencies.<sup>282</sup> Contractors may also seek extraordinary contractual relief (ECR) for situations not covered by an indemnity clause. ECR can be sought whether or not a contract with the government exists, so long as granting relief will facilitate the national defense. Seeking either indemnification or ECR has its challenges.

### **A. Indemnification Under Public Law 85-804**

#### **1. "Unusually Hazardous" Risks**

The risks incident to war alone typically do not qualify as unusually hazardous risks.<sup>283</sup> The Armed Services Board of Contract Appeals has held that: "war risk coverage, whether through insurance or indemnification is generally treated not as an extraordinary contractual matter but as a normal aspect of the procurement function."<sup>284</sup>

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<sup>282</sup> For example, the Army is the only agency that has indemnified "nonsudden" environmental releases. See *infra* notes 290-339 and accompanying text.

<sup>283</sup> See Cong. Rec. H1252, Mar. 20, 1997 ("all war risks resulting from the provision of airlift services for a CRAF mission, in accordance with the contract, are unusually hazardous risks, and shall be indemnified to the extent . . . not covered by insurance").

<sup>284</sup> See *Les Etablissements Eiffel-Asie*, ASBCA No. 22596, 80-2 BCA ¶ 14,500 (upholding validity of "War Risk" clause in Navy contract) (citations omitted) ("we find no justification for the Government's basic premise that a clause indemnifying against loss due to hostile combat action must come within the purview of P.L. 85-804"). One  
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The legislative history reveals, “The need for indemnity clauses in most cases arises from the advent of nuclear power and the use of highly volatile fuels in the missile program.”<sup>285</sup> Similar authority had just been passed in the few preceding years to indemnify for nuclear incidents and risks in research and development contracts.<sup>286</sup> The main consideration supporting a need for indemnification was the potential for uninsurable catastrophic disasters from nuclear or high-energy explosions. Congress was concerned about the same risks attendant to production contracts:

[P]roduction contracts may involve items, the production of which may include a substantial element of risk, giving rise to the possibility of an enormous amount of claims . . . . The magnitude of the risks involved under procurement contracts in these areas have rendered commercial insurance either unavailable or limited in coverage . . . to the extent that commercial insurance is unavailable, the risk of loss in such a case should be borne by the United States.<sup>287</sup>

Congress never envisioned the clause would be applied to pay for pollution.

## **2. A Matter of Agency Discretion**

The contractor has no right to insist that the INDEMNIFICATION UNDER PUBLIC LAW 85-804 clause be included in its contract. In a bid protest alleging that a

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notable exception is the use of indemnification by the Air Force to protect the Civil Reserve Air Fleet (CRAF). CRAF aircraft are commercial aircraft that are called into action to provide troop transport and logistical support in wartime. These aircraft would be lawful targets under the Geneva Convention, yet commercial airline insurance exempts damage incident to war from coverage. The Air Force historically has indemnified such losses, which would otherwise potentially devastate the industry.

<sup>285</sup> Eiffel-Asie, *supra* note 284, citing Legislative History, Pub. Law 85-804, S. Rep. No. 2281, 85th Cong., 2d Sess., *reprinted in* 1958 U.S. Code Cong. & Ad. News 4043, 4045.

<sup>286</sup> An Act of July 16, 1952, Pub. Law No. 82-557, 66 Stat. 725, ch. 882 (codified at 10 U.S.C. §2354 (2002)). An Act to Amend the Atomic Energy Act of 1954 (later known as the Price-Anderson Act), Pub. L. No. 85-256, 71 Stat. 576 (1957).

<sup>287</sup> *Id.*

solicitation was defective for not including this clause in an ordnance-handling contract, the GAO upheld the Navy's discretion to decide what situations involve "unusually hazardous or nuclear risks."<sup>288</sup> GAO stated that, "the risk of liability without insurance . . . does not make the solicitation inappropriate or improper."<sup>289</sup> As discussed below, the use of 85-804 indemnity clauses for cleanup costs varies among agencies.

### **3. 85-804 Indemnification Varies among Agencies**

#### **a) DOE**

Originally, indemnification of individual contractors was subject to DOE discretion under either Public Law 85-804 or the Price-Anderson scheme. The latter provided that DOE could enter into agreements of indemnification under contracts "involving activities under the risk of public liability for a substantial nuclear incident."<sup>290</sup> Although authorized, DOE rarely used Public Law 85-804 (perhaps due to the availability of Price-Anderson indemnification).<sup>291</sup> Under either authority, indemnification was discretionary and a matter of contract negotiation.

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<sup>288</sup> Day Zimmerman Hawthorne Corporation, B-287121, 2001 CPD ¶ 60 [hereinafter DZHC]. DZHC argued that the Navy was required to offer indemnification because of the risks involved in ordnance handling.

<sup>289</sup> *Id.* (citations omitted).

<sup>290</sup> Act to Amend the Atomic Energy Act, *supra* note 249.

<sup>291</sup> From 1969 to 1979 DOE used Public Law 85-804 only ten times and its use was based on management versus legal considerations. NASH & CIBINIC, *supra* note 29, at 2246 citing 41 C.F.R. § 9-17.204-51 (Department of Energy Regulations then in place governing use of Public Law 85-804).

As discussed at length above,<sup>292</sup> the Price-Anderson Amendments Act of 1988 now pre-empt DOE's use of 85-804 indemnity for nuclear risks.<sup>293</sup> Consistent with this statutory mandate, DOE now includes the Price-Anderson indemnification (called statutory indemnity) in all contracts that involve any risk of nuclear liability.<sup>294</sup> The DOE Acquisition Regulation [hereinafter DEAR] also allows for the potential for additional "General Contract Authority Indemnity . . . to protect a DOE non-management and operating contractor against liability for uninsured nonnuclear risks."<sup>295</sup>

Management and operating contractors run DOE facilities and receive special treatment in the DEAR.<sup>296</sup> The M&O contracts are hybrid contracts, in some cases including aspects of several FAR contract types.<sup>297</sup> The M&O contractor runs the DOE facility much as if it were run by government employees, with the major exception that the rights and obligation of the parties are established by contract. The M&O contracts

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<sup>292</sup> See text accompanying notes 248-265, *supra* Section IV.C.(3).

<sup>293</sup> See 42 U.S.C. § 2210(d) (2002).

<sup>294</sup> Department of Energy Acquisition Regulation [hereinafter DEAR] (indemnification sections codified as amended at 48 C.F.R. Parts 950, 952 and 970).

<sup>295</sup> DEAR 950.7101. The DOE INSURANCE-LITIGATION AND CLAIMS clause is required for contracts over \$100 million and contains limitations for non-M&O contractors concerning reimbursement for liabilities to third parties—cost are not reimbursable to the extent they were or should have been insured, if they are unreasonable or otherwise unallowable, or if they arise from willful misconduct, lack of good faith, or "failure to exercise prudent business judgement." DEAR 952.231-71, 67 Fed. Reg. 14,872 (2002) (to be codified at 48 C.F.R. pt. 952). Nearly identical requirements for M&O contractors are found at DEAR 970.5228-1.

<sup>296</sup> DEAR Part 970 (containing exhaustive parallel treatment to dozens of FAR requirements).

<sup>297</sup> DEAR 970.5200.

are cost-reimbursement contracts, so recovery of environmental costs does not arise through indemnity, but rather as a reimbursable cost of doing business on DOE's behalf. M&O contractors must comply with all laws, regulations, and DOE Directives<sup>298</sup> including those related to environment, safety, and health (ES&H). The contractors' fee for performing the work is linked, in part to ES&H success. The M&O contractor also has the burden to prove costs incurred for remediation or paid to third parties for environmental liability are both reasonable and allowable.

Before 1995, M&O contractors were chiefly responsible for cleaning up contaminated buildings, soil, and groundwater arising from fifty years of producing and storing nuclear materials.<sup>299</sup> DOE spent \$6 billion annually for nuclear waste cleanup, but paid its contractors regardless of what was accomplished.<sup>300</sup> Dissatisfied with this approach, DOE began a "privatization initiative" to foster competitive, fixed-price contracts—payment would be linked to cleanup.<sup>301</sup> Regrettably, the "privatization initiative failed to achieve significant cost savings, keep projects moving forward on schedule, or improve contractors' performance."<sup>302</sup>

The problem with a "one size fits all" contracting approach is that fixed-price contracts are ill suited to the significant uncertainties of many radioactive and hazardous

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<sup>298</sup> DEAR 970.0470-2.

<sup>299</sup> NUCLEAR WASTE: OBSERVATIONS ON DOE'S PRIVATIZATION INITIATIVE FOR COMPLEX CLEANUP PROJECTS, GAO/T-RCED-00-215 at 1 (June 22, 2000).

<sup>300</sup> *Id.* It is forecast to cost \$150-\$195 billion for complete remediation/monitoring.

<sup>301</sup> *Id.*

<sup>302</sup> *Id.*



waste cleanup projects. Unless the scope of the work is well defined, bidders will be unable to reasonably anticipate the work required. When there are too many unknowns, it is not plausible to think that bidders are offering realistic prices.

Contractors should not be expected to bear the risk when there are great unknowns and uncertainties about those very risks. All contractors would be motivated to include contingencies in their bids to account for these risks. Contingencies hurt the government by raising prices for work that might never need to be performed. It is a bad idea for the government to pay for this bidding cushion. Even worse, the contractor who is least cautious (lowest or no contingency) will be first in line for award, because award is made to the lowest, responsive, responsible bidder. Any underestimating due to these uncertainties will lead to cost overruns for the contractor and performance problems.<sup>303</sup>

#### **b) Army**

The Army has specifically extended the definition of “unusually hazardous risks” to compensate contractors for certain costs of environmental cleanup.<sup>304</sup> In 1985, the Secretary of the Army first authorized 85-804 indemnification to cover contractor environmental activities at two Army Ammunition Plants (AAPs).<sup>305</sup> The AAPs were

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<sup>303</sup> *Id.* GAO suggested nuclear waste contracts be tailored to appropriate situations; a number of factors, including “the risks involved in the project and the entity that is best prepared to assume them,” should be considered in deciding contract type and financing.

<sup>304</sup> For an exceptional analysis of Army treatment of environmental cleanup costs at GOCOs see, Mark J. Connor, *Government Owned-Contractor Operated Munitions Facilities: Are They Appropriate in the Age of Strict Environmental Compliance and Liability?*, 131 MIL. L. REV. 1 (1991).

<sup>305</sup> *Id.*, citing Memorandum of Decision, Office of the Secretary of the Army, subject: Authority Under Public Law 85-804 to Include an Indemnification Clause In Contracts for Lake City and Newport Army Ammunition Plants, May 31, 1985.

GOCO facilities facing millions of dollars in environmental cleanup costs arising from decades of manufacturing military explosives.<sup>306</sup> “Unusually hazardous risks” were defined for the first time to include, “*damages arising out of the use, disposal, or spillage of such toxic chemicals and other hazardous materials, including environmental damages.*”<sup>307</sup>

The Army offered similar environmental indemnification to eighteen AAPs in 1990.<sup>308</sup> This indemnity protects the contractors that operate these AAPs today.<sup>309</sup> The definition of unusually hazardous risk includes releases or threatened releases, sudden or non-sudden, on-site or off-site, during the handling of any substance “which is or becomes regulated by law.”<sup>310</sup> The Army limited the indemnification where the release was the result of non-compliance (with the intent or knowledge of the Contractor's

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<sup>306</sup> *Id.* at 4. GAO estimated total costs to remediate all 20 ammunition plants will be about \$800 million. ENVIRONMENTAL CLEANUP: DEFENSE INDEMNIFICATION FOR CONTRACTOR OPERATIONS, GAO/NSIAD-95-27, Nov. 1994, at 7.

<sup>307</sup> Connor, *supra* note 304, at 21 (emphasis added).

<sup>308</sup> Memorandum of Decision, Office of the Secretary of the Army, subject: Authority under Public Law 85-804 to Include an Indemnification Clause in Contracts for the Operation of Government Owned Ammunition Plants, Nov. 14, 1990 [hereinafter Ammunition Plant Indemnification]. The memorandum was issued in response to coordinated negotiations with contractors at all such facilities at a time when these facilities were run using cost-type contracts. Interview with Paul David Harrington, Chief of Business Operations Law Division, Office of Command Counsel, Army Materiel Command, June 5, 2002.

<sup>309</sup> Interview with Paul David Harrington, *id.*

<sup>310</sup> Ammunition Plant Indemnification, *supra* note 308 app. B.

principal officials) with environmental laws or regulations applicable at the time of the release.<sup>311</sup>

These limitations sound much like the “wrongfulness” considerations enunciated later in the DCAA Audit Manual, with the significant caveat that Army indemnification allows reimbursement despite noncompliance where the contractor’s principal officers are ignorant of the noncompliance. Additionally, while the Army Memorandum authorizing indemnification explicitly denied recovery for criminal fines and penalties, it was silent as to recovery for civil fines and penalties.<sup>312</sup>

The Army’s inclusion of nonsudden releases extended the definition of “unusually hazardous” risks. Perhaps this was done to facilitate funding so GOCO cleanups could commence more quickly or because the Army (as landowner) was liable as a CERCLA PRP. In any event, “the Army must be concerned by the extremes to which it has stretched the definition of ‘unusually hazardous.’”<sup>313</sup>

#### c) Navy

“The Navy has not provided indemnification for non-nuclear hazardous work, with the exception of repairing the U.S.S. Cole after it was the target of a terrorist

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<sup>311</sup> Connor, *supra* note 304, at 40-41, citing Memorandum of Decision, Office of the Secretary of the Army, subject: Authority under 50 U.S.C. §§1431-1435 (Pub. L. 85-804) to Include an Indemnification Clause in a Contract with Hercules Incorporated, Oct. 30, 1989. The limits do not apply when the contractor is not to blame for noncompliance (such as noncompliance caused by the design or condition of Government-furnished equipment or facilities, or the result of the Contractor's compliance with specific written instructions from the Contracting Officer). *Id.*

<sup>312</sup> Ammunition Plant Indemnification, *supra* note 308.

<sup>313</sup> Connor, *supra* note 304, at 23. “[Except for explosives] the vast majority of hazardous or toxic substances used by contractors at Army GOCO munitions facilities (e.g., solvents and heavy metals) are used throughout American industry.” *Id.*

explosion.”<sup>314</sup> That being said, the Navy also routinely approves indemnification requests for its nuclear contractors.<sup>315</sup> Additionally, the Navy indemnified three of its contractors who disposed of low-level radioactive waste at the Maxey Flats nuclear waste disposal facility in Kentucky for contamination spreading from that site.<sup>316</sup> The 85-804 indemnity arose from contracts approved in the 1960’s. While CERCLA litigation concerning contribution among the PRPs for contamination at Maxey Flats continues, the Navy has assumed all three contractors’ remediation costs since the 1980’s.<sup>317</sup>

#### **d) Air Force**

The Air Force applies Public Law 85-804 narrowly, and strictly in accordance with Executive Order 10789 (as amended). Air Force policy is to employ a two-step analysis for review of indemnification requests. First, “whether the risks for which the contractor seeks indemnification are unusually hazardous or nuclear in nature.”<sup>318</sup> Next, “whether the contractor’s insurance coverage and other financial protection are adequate,

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<sup>314</sup> DZHC, *supra* note 288, citing Navy Supplemental Report of The Deputy Counsel to the Assistant Secretary for the Navy for Research, Development and Acquisition.

<sup>315</sup> In 1995, for example, the Navy authorized 33 Public Law 85-804 indemnity actions while the Army and Air Force together approved only two actions. In 1996, the Navy approved such indemnification 38 times while the Army and Air Force each authorized it twice. Cong. Rec. H2549-2550, Mar. 20, 1996; Cong. Rec. H1242, Mar. 20, 1997.

<sup>316</sup> ENVIRONMENTAL CLEANUP: DEFENSE INDEMNIFICATION FOR CONTRACTOR OPERATIONS, GAO/NSIAD-95-27, Nov. 1994.

<sup>317</sup> *Id.* at 5. These contractors’ liability was estimated at \$2 million for costs from 1987-95. For ongoing litigation, *see, e.g.*, Aetna Cas. & Sur. Co. v. Nuclear Engineering Co., 2002 WL 363373, Mar. 8, 2002 (Ky. App. 2002) (litigation concerning whether “damages” in general liability insurance policies includes remediation costs).

<sup>318</sup> SAF/CG, Memorandum for SAF/AL dated Sept. 14, 1984, at Section 1, *Guidelines for Consideration and Analysis of Indemnification Requests* (Memorandum on file with author).

taking into account the availability and cost of additional insurance.”<sup>319</sup> Few risks qualify for indemnification.

Over the decades, “one thing has remained constant . . . indemnification under Public Law 85-804 has only been provided under rare and unusual circumstances.”<sup>320</sup> The Air Force has approved its use for only a handful of programs, primarily those involving highly explosive propellants for rockets and missiles or war risks associated with the Civil Reserve Air Fleet (CRAF) upon activation.<sup>321</sup>

While each contract contains its own agreed upon clause, a typical indemnification clause with the Air Force for risks deriving from rocket or missile booster production defines unusually hazardous risks in terms of risk of explosion:

[I]t is agreed that all risks resulting from or in connection with the explosion, detonation, impact or burning or combination thereof, of an assembled or partially assembled missile, simulated missile or rocket motor, utilizing the material delivered under this contract is an unusually hazardous risk.<sup>322</sup>

The typical clause does not mention environmental liability. To the extent toxic pollution stems from an explosion, detonation, etc., it is arguably encompassed within the “all risks resulting from or in connection with” language. Some clauses specifically mention toxic risks. Where toxic hazards are specifically discussed, the bounds of the

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<sup>319</sup> *Id.*

<sup>320</sup> *Id.* at p.6. As of the date of that memo, the Air Force had only authorized indemnification in conjunction with eight programs. The same policy continues to the present. Interview with Marcia J. Bachman, Air Force General Counsel Point of Contact for Indemnification Issues, May 31, 2002.

<sup>321</sup> Interview with Marcia J. Bachman, *id.*

<sup>322</sup> Definition of Unusually Hazardous Risk for Minuteman Contracts, Memorandum of Approval, Mar. 29, 1976 (Memorandum on file with author).

indemnity provided is governed by the scope of the language regarding these risks. The following clause is used for illustrative purposes:

[T]he toxic, explosive, or other unusually hazardous properties of chemicals or energy sources used for or in conjunction with the performance of this contract . . . are “unusually hazardous risks” whether or not the contractor’s liability arises from the design, fabrication, or furnishing of other products or services under this contract.<sup>323</sup>

While at first blush this language may appear to broadly indemnify the contractor for toxic liability, including liability for the effects of pollution, the language restricts relief to performance of the contract. The contract at issue was for launch services to place DoD satellites in orbit. The decision authorizing indemnification states that “indemnification applies to government missions only, and will not cover commercial launches.”<sup>324</sup> The circumstances justifying the decision state: “The landfall of an expendable launch vehicle on a populated area (with or without an attendant detonation) could result in both the loss of life and property damage of catastrophic proportions.”<sup>325</sup> The memo continues: “In light of the recent propellant explosion . . . in Henderson Nevada, the tragedy in Bhopal, India, and the Shuttle disaster of February 1986, third-party liability insurance of the magnitude required to adequately protect the prime contractor and his subcontractors is no longer available.” True to form, the Air Force indemnified the contractor only to cover the risk of a catastrophic accident where insurance was otherwise unavailable.

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<sup>323</sup> Memorandum of Decision Approving Inclusion of Indemnification Under Public Law 85-804 clause in Contract F04701-85-C-0019, Titan IV Expendable Launch Vehicle, app. 1 (undated) (Memorandum on file with author).

<sup>324</sup> *Id.* at CIRCUMSTANCES JUSTIFYING DECISION.

<sup>325</sup> *Id.*

It may be easier to understand these limitations when looking at a situation that was found not to be unusually hazardous. "The Air Force does not indemnify under Public Law 85-804 producers of air-to-ground nuclear weapons, nor does the Air Force indemnify manufacturers whose aircraft may carry these weapons."<sup>326</sup> The nature of these programs "does not expose the contractor to risks and losses normally contemplated under the indemnification concept of unusually hazardous or nuclear risks."<sup>327</sup>

Air Force indemnity only applies to potentially catastrophic accidents (such as missiles exploding or falling from the sky). It does not protect purposeful or willful behavior surrounding disposal of hazardous waste. This philosophy, applying indemnification only to uncontrolled releases, is most consistent with the underlying rationale for indemnification in the first place. The indemnity is intended to absorb the liability for accidents that cannot be prevented despite use of the utmost care. Consistent with the common law notion of strict liability for ultrahazardous activities, the party benefiting from these activities (in this case the government) pays the price for ultrahazardous activities because no amount of precautions can render the practice completely safe. Much like the prototypical common law torts case involving blasting, the ultrahazardous risk is the risk of explosion, not the risk of pollution from the byproducts of making the explosive.

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<sup>326</sup> Ira L. Kemp, Associate Deputy Assistant Secretary of the Air Force (Contracting), Assistant Secretary (Acquisition), Memorandum for AFPEO/ST, July 23, 1992 (Memorandum on file with author).

<sup>327</sup> *Id.*

**e) NASA**

NASA created a blanket policy for indemnification in 1983.<sup>328</sup> While each request for indemnification continued to be considered independently, only those classes of unusual risks identified by NASA were authorized. Further, only contract activities associated with the Space Transportation System (Space Shuttle) were eligible for indemnification. This blanket indemnification authority was meant to address the issue globally, but allow decentralized processing under a common set of rules.

The scope of relief was severely constrained through the SPACE ACTIVITY—UNUSUALLY HAZARDOUS RISKS clause. It authorizes indemnification solely for activities beginning when “products or services are provided to the U.S. Government at a U.S. Government installation for one or more Shuttle launches and are actually used or performed in NASA’s space activities.”<sup>329</sup> NASA clearly limited liability to the launch itself (and associated launch and mission activities) as opposed to research, development, production, or even delivery hazards associated with the rocket boosters or the cargo to be carried. It would be inconceivable to argue that toxic cleanup liability attached under this scheme unless there was a chemical release incident to or awaiting the launch.

In 1995, NASA abandoned the blanket authorization scheme, since individual justifications for indemnification needed to be considered anyway under the FAR.<sup>330</sup> The effort was part of a NASA push to streamline its acquisition policies and conform them to

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<sup>328</sup> NASA, MEMORANDUM DECISION UNDER PUBLIC LAW 85-804, Jan. 19, 1983.

<sup>329</sup> *Id.* at 8, Guideline III. With this constraint, any covered pre-launch release would occur on the government installation, so the government would have authority for any immediate response action or removal at the site.

<sup>330</sup> 60 Fed. Reg. 18,032-18,034 (1995).



the FAR. While the procedures may have changed, NASA's philosophy does not appear to have changed, as indemnification remains extremely limited.<sup>331</sup>

Unlike the Army and Navy, NASA has not used indemnity to insulate contractors from cleanup liability. The analysis below further discusses such disparities faced by contractors and other problems with the current Public Law 85-804 indemnification scheme. It also makes recommendations to overcome these shortcomings.

#### **4. Indemnification Observations and Recommendations**

The most striking features of the 85-804-indemnification scheme are (1) that a justification for including this contingent liability is mandated and (2) that the definition of the unusually hazardous or nuclear risk, as agreed by the parties, is included in the contract. "Generally, courts agree that a provision in an indemnity agreement, which contains broad language sufficient to indicate that the parties intended to include all liabilities, will include environmental liabilities as well even without specific reference to an environmental statute such as CERCLA."<sup>332</sup> Unlike the broad language of the World War II indemnification clauses, Public Law 85-804 clauses directly set out the scope of the indemnification as part of the contract itself. "If an indemnity agreement does not include broad language but rather limits indemnity to specific types of claims, environmental costs will be excluded unless the agreement contains a clear and unambiguous reference to such costs."<sup>333</sup>

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<sup>331</sup> *Id.* (indemnity only approved on contracts for launch services on Shuttle and expendable launch vehicles).

<sup>332</sup> *Olin Corp. v. Yeargin Inc.*, 146 F.3d 398, 407 (6th Cir. 1998).

<sup>333</sup> *Id.*

Public Law 85-804 indemnification for environmental costs is not granted consistently among agencies. While both the Army and the Navy have afforded environmental relief under special circumstances, only the Army ammunition plant agreements clearly afford relief for nonsudden releases within their definition of risks covered. The narrowest approach, followed by NASA and the Air Force, affords protection only for catastrophic releases.<sup>334</sup> Tort liability or cleanup costs associated with the toxic or explosive release of a rocket or missile explosion would arguably be covered under even the narrowest of “ultrahazardous risk” definitions.

Other than these inconsistencies, the current system does a fairly good job harmonizing the need for a strong national defense with a desire that those responsible for pollution pay for its abatement.<sup>335</sup> Eliminating inconsistencies would require new legislation, a change to the executive order, or a change to the FAR. A FAR change could eliminate inconsistencies, but could not relax the requirement that indemnity only be afforded in the face of unusually hazardous or nuclear risks. Like the courts, neither the agencies themselves nor the FAR council can misconstrue the law “in light of public policy to facilitate environmental clean-up efforts.”<sup>336</sup> Because the restriction to use

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<sup>334</sup> The insurance industry likewise does not currently consider environmental contamination an insurable risk (at a reasonable cost) in most circumstances. The major exception is a sudden accidental contamination, such as an oil tanker spill resulting from a collision. DCAAM 7640.1, Vol. 1, § 7-2120.11 (Jan. 2002).

<sup>335</sup> *But see*, Stuart B. Nibley, Keith A. Onsdorf, and Steven L. Schooner, *The Unmovable Object (National Security) Meets the Irresistible Force (Environmental Protection)*, 55 FED. CONT. REP. 24 at d29, June 17, 1991 (contending that government contractors are being crushed in the middle and advocating broader use of 85-804 relief).

<sup>336</sup> Rockwell Int’l, *supra* note 212, at n.24.

indemnification only for unusually hazardous or nuclear risks stems from the executive order, a higher level change (congressional or presidential) is preferable.

A better program could be modeled on the Price-Anderson Amendments of 1988. With a few strokes of the scrivener's pen, the Atomic Energy Act could be modified to require that the federal government indemnify all contractors of (not just DOE contractors) for nuclear incidents under the Price-Anderson scheme. Uniform nationwide indemnity would promote certainty among contractors and the insurance industry. Uniform indemnity would also afford peace of mind to those most likely impacted by a nuclear incident. Finally, universal mandatory coverage would ensure all those similarly situated would be treated equally.

The same principles guiding the nuclear risk scheme could be legislated to demand indemnification of government contractors for non-nuclear "ultrahazardous risks." To work, Congress would have to define ultrahazardous risks. The uniform definition of the ultrahazardous risks to be indemnified would ensure that Congress speaks for the people in deciding how to strike the proper balance between the "polluter pays principle," the concept of sovereign immunity, and the need for a powerful defense industrial base. Congress could clearly and specifically waive sovereign immunity for certain environmental risks, rather than permitting the courts to decipher exceptions to the Federal Tort Claims Act or decide public policy matters one case at a time.

Second, the indemnification scheme should be mandatory and exclusive. A uniform definition would eliminate most of the substantive differences between agencies concerning Public Law 84-804 relief. A mandatory and exclusive system would ensure that contractors are not treated differently due to bargaining power or agency bias.

Third, Congress should retroactively apply indemnification to cover all existing contractors and former contractors who supplied products or services giving rise to the statutorily-defined ultrahazardous risks. Retroactive application would ensure that former contractors stand on equal footing with present contractors. It would offset the retroactive application of CERCLA and the lengthy latency periods that are so problematic for toxic torts.

Fourth, indemnity should afford relief only above and beyond available insurance. Ordinary environmental liability insurance would become more affordable because of limited liability—the government’s umbrella of indemnification kicking in for catastrophic situations and the contractor’s insurance covering lesser liabilities.

Fifth, “persons indemnified” should extend to subcontractors and suppliers. Extending protection to subcontractors and suppliers prevents shifting the blame for an accident while at the same time providing a safety net to those injured.

As with any proposed new scheme, the devil is in the details. Defining “ultrahazardous risks” broadly versus narrowly is certain to appeal to some and offend others. “Drawing sharp battle lines with the White House, Democratic leaders of the Senate are moving to force a showdown on a measure that would . . . reinstate an industry tax that was a main source of money for the [Superfund] program until 1995.”<sup>337</sup> Many in Congress prefer to have industry versus government pay these billions of dollars to fund environmental cleanup. Taxes are always controversial; environmental issues rouse passionate congressional sentiments; increased budgets for the military are popular only

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<sup>337</sup> Raymond Hernandez, *Political Battle Looming Over Superfund Plan*, N.Y. TIMES, Apr. 15, 2002, at A18.

when the nation feels patriotic or threatened. In such a highly charged arena, a proposal to increase taxes and increase military funding to pay defense contractors' environmental liability may never come to fruition.

If Congress cannot agree on new legislation, the President, by issuing a new Executive Order implementing Public Law 85-804, could define ultrahazardous risks uniformly (for all agencies authorized to use 85-804). The President could also determine that universal indemnification of any contractor facing such risks facilitates the national defense. Such a scheme would create a dichotomy of "haves" (defense contractors) and "have-nots" (contractors confronting these risks on their own). The scheme could come under fire from those contractors that must bear these risks. Like the present scheme, balancing and reconciling these diametrically opposed concerns is not easy. Also, the less ad hoc the approach, the more vulnerable the policy is to shifts in the balance of current environmental or defense policies or new legislation. Thus, a legislative mandate prescribing indemnification for all contractors doing business with the federal government is preferable to a new executive order.

Another option would be to modify the FAR so that all agencies would treat environmental costs in the same manner. Like NASA's blanket indemnification, the difficult issues could be resolved globally in a consistent, universal approach, yet agencies could continue decentralized processing under a common set of rules. To this end, a common set of rules and procedures would need to be developed and implemented. The chief advantage to this approach is that no new legislation or executive action is required.

There are many disadvantages. Changing the FAR could not water down the requirement that only unusually hazardous risks be reimbursed. This would be contrary to the polluter pays principle. It would also fly in the face of current congressional sentiment requiring DoD to seek recoupment of cleanup costs from its defense contractors.<sup>338</sup> It would be difficult to convince the agencies to adopt such an approach in this political climate. Even if adopted, any relief obligating funds in excess of \$25 million would be subject to congressional veto. Finally, such an approach could cause Congress to revoke or severely limit Public Law 85-804 authority. According to one commentator, "Given the mood of Congress and the country's fiscal problems, continued imaginative use of the term 'unusually hazardous' likely will result in congressional action limiting DOD's use of PL 85-804 . . . ."<sup>339</sup>

Because of the aforementioned hurdles, congressional, presidential or FAR council changes to expand environmental indemnification may never occur. If the indemnification scheme is not changed to allow broader indemnity for environmental liability, contractors may still seek extraordinary contractual relief.

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<sup>338</sup> National Defense Authorization Act for Fiscal Year 1998, Pub. L. No. 105-85, 111 Stat. 1629, 1689-90 (1997), Sec. 348, Recovery And Sharing of Costs of Environmental Restoration at Department of Defense Sites (also reported at 10 U.S.C. § 2701 note). The Act requires the Secretary of Defense to prescribe regulations concerning cost-recovery at Department of Defense sites from contractors of the Department and other private parties that contribute to environmental contamination at such sites and cost-sharing (the sharing of the costs of such restoration with such contractors and parties).

<sup>339</sup> Connor, *supra* note 304, at 42.

## B. Extraordinary Contractual Relief (ECR)

Public Law 85-804's paramount purpose is, "[t]o authorize the making, amendment, and modification of contracts *to facilitate the national defense*."<sup>340</sup> The requirement to facilitate the national defense is also the most import limitation on the discretion to use this authority.<sup>341</sup> The other significant limitation is that ECR is reserved for contractors otherwise lacking legal recourse under the contract.<sup>342</sup> Whether relief is available depends on "whether the needs of the government are such that relief should be given a contractor."<sup>343</sup>

Contractors should aggressively pursue both ECR and relief under the contract if uncertain about whether adequate legal remedies are available.<sup>344</sup> Ignoring legal remedies or withdrawing contract appeals hurts the contractor when relief is denied through the ECR process.<sup>345</sup> A contractor must also remain mindful that pursuing any

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<sup>340</sup> Pub. L. No. 85-804, *supra* note 7, "AN ACT" clause (emphasis added).

<sup>341</sup> As proclaimed in the executive order and implemented through the FAR, this requirement is manifested in an obligation to make a written finding that the action (whether indemnification or extraordinary relief) "will facilitate the national defense." Exec. Order No. 10789, *supra* note 20, FAR 50.203(b)(1) and 50.403-2(a)(3).

<sup>342</sup> FAR 50.203(b)(2). ECR does not include correcting alleged mismanagement, fraud, waste, or corruption. Automated Power Systems, Inc., DOT BCA No. 85-804-161995 DOT BCA LEXIS 8, *reconsideration denied*, 1995 WL 246495 (T.C.A.B.).

<sup>343</sup> Automated Power, *id.*

<sup>344</sup> Embassy Moving & Storage Co. v. United States, 191 Ct. Cl. 537, 545, 424 F.2d 602, 607 (1970) (Public Law 85-804 affords an "*ex gratia* remedy, which does not preclude later judicial relief.").

<sup>345</sup> Hicks Corp. v United States, 203 Ct. Cl. 65, 72, 487 F.2d 520, 524 (1973) (contractor's decision withdrawing an appeal to the Armed Services Board of Contract Appeals [hereinafter ASBCA] to instead apply for relief under Public Law 85-804 voluntarily and irrevocably extinguished its rights to sue on the contract).

remedy available under Public Law 85-804 does not toll or extend jurisdictional prerequisites to ordinary contractual relief.<sup>346</sup> However, the fact that a contractor previously may have been denied relief under Public Law 85-804 does not deprive the boards of contract appeals of jurisdiction over an appeal based upon another contract theory.<sup>347</sup> A decision under 85-804 does not depend on rights under the contract; rather, the determination concerns whether such relief would facilitate the national defense.<sup>348</sup>

The biggest challenge to securing extraordinary relief is that such relief is entirely within the discretion of the agency. Further, the agency boards of contract appeals and the courts are powerless to compel extraordinary relief, because ECR depends upon an administrative determination that such relief would facilitate the national defense. That determination is committed to the sole discretion of the President or his delegates.<sup>349</sup> In short, the contractor's fate lies entirely in the hands of the agency and there is no avenue for appeal if the contractor is dissatisfied with the result. The Navy's A-12 program affords a recent dramatic example of these perils. Instead of receiving extraordinary

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<sup>346</sup> *Henry Products Co. v. United States*, 180 Ct. Cl. 928, 930 (1967).

<sup>347</sup> John J. Eufemio, ASBCA No. 26625, 82-2 BCA ¶ 15,990.

<sup>348</sup> *Gentex Corp.*, ASBCA No. 24040, 79-2 BCA ¶ 14,139.

<sup>349</sup> “[D]ecisions of contract adjustment boards are final and not subject to review, either by an agency board of contract appeals or by a court.” *International Gunnery Range Servs. v. Widnall*, 1995 U.S. App. LEXIS 24158, 40 Cont. Cas. Fed. (CCH) ¶ 76,835 (Fed. Cir. 1995 unpublished) citing *Murdock Machinery & Engineering Co. of Utah v. United States*, 873 F.2d 1410, 1413 n.1 (Fed. Cir. 1989); *Coastal Corp. v. United States*, 713 F.2d 728, 731 (Fed. Cir. 1983). *See also* *Vanguard Industrial Corp.*, ASBCA No. 28361, 84-1 BCA ¶ 17,150 (denial of relief is not appealable under Contract Disputes Act (CDA) [41 U.S.C. §§ 601-613 (2002)] and was not appealable prior to the CDA).



relief to bail out the flagging program, the contract was terminated for default.<sup>350</sup> More than a decade later litigation continues.<sup>351</sup>

Contractors can turn to 85-804 “residual powers” when they have no existing contract with the government. If they have an open contract, there are two types of amendment without consideration available as extraordinary relief under the FAR: to maintain a contractor *essential to the national defense* and out of *fairness* to the contractor. Both could afford financial relief from environmental liability. While the latter section broadly provides for relief,<sup>352</sup> environmental liability has been granted only under the former. Both are also limited by the potential congressional veto if financing approved by the adjustment boards exceeds \$25 million.

The first section below discusses cases where the contractor has been found to be essential to the national defense and relief was granted to help the contractor overcome costs of environmental cleanup. The next section discusses how contractors have been unsuccessful in using fairness as a basis for recovery.

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<sup>350</sup> See *McDonnell Douglas Corp. v. United States*, 182 F.3d 1319, 1323 (Fed. Cir. 1999), *reh'g, en banc, denied*, 1999 U.S. App. LEXIS 31383 (Oct. 29, 1999), *cert. denied*, 529 U.S. 1097 (2000). Then-Secretary of Defense, Richard Cheney, denied an 85-804 request to restructure the contract as a cost-reimbursement contract; instead, just two days later, the contract was terminated before a \$553 million payment became due. See also *McDonnell Douglas Corp. v. United States*, 50 Fed. Cl. 311 (2001) (upholding default).

<sup>351</sup> “The A-12 termination for default case drags on. . . .” Leroy H. Armes, Melanie I. Dooley, and Martha A. Matthews, *Outlook For Issues Affecting Federal Procurement In 2002*, 77 FED. CONTR. REP. 5 at 146 (Feb. 5, 2002).

<sup>352</sup> For example, under the fairness rubric, DOE has loosely construed the requirement to facilitate the national defense. “[G]rant of this relief will facilitate the national defense by assuring contractors . . . the Department of Energy . . . will abide by its contracts.” Systems Research, ECAB No. 3-8-78, 3 ECR Reporter ¶ 116, Aug. 29, 1978. Using this rationale, any decision in favor of the contractor satisfies “fairness.”

## 1. "Essential" to National Defense

FAR 50.302-1(a) provides: "When an actual or threatened loss under a defense contract, however caused, will impair the productive ability of a contractor whose continued performance on any defense contract . . . is found to be essential to the national defense, the contract may be amended without consideration . . . to the extent necessary to avoid such impairment."

As applied by contract adjustment boards, there are two key requirements to determine whether a contractor is essential to the national defense. First, contractors must offer a unique product or one that cannot be obtained elsewhere in sufficient time or in sufficient quantities to meet defense needs. A classic example was the Army's ECR relief to Bioport, at the time the sole producer of the anthrax vaccine.<sup>353</sup> Second, contractors must face such dire financial conditions that extraordinary relief is essential to the contractor's continued ability to provide the needed product.<sup>354</sup> Mere threats of delay or interruption due to serious financial difficulties are not sufficient for the granting of extraordinary relief.<sup>355</sup>

To date, CABs have granted relief for environmental liabilities to only three contractors. Examining the circumstances of when relief was granted or denied shows

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<sup>353</sup> Bioport Corp., ACAB No. 1246, July 27, 1999, 1999 WL 33233099. The Army Contract Adjustment Board (ACAB) awarded \$24.1 million in relief (primarily advance payments) to Bioport because, "Anthrax presents a clear and present danger . . . [and] Licensing a facility to produce anthrax vaccine is very complex and time consuming."

<sup>354</sup> The Air Force, for example, provides for an audit to determine the extent of financial difficulties and mandates an essentiality determination "shall include a detailed statement of the contractor's financial condition and projection of financial assistance needed for continued viability." AFFAR 5350.305-90, 48 C.F.R. § 5350.305-90 (2002).

<sup>355</sup> Application of Varo, Inc., 2 ECR ¶ 128, Apr. 5, 1971.

how limited such relief has been in practice. The cases also demonstrate that relief is only granted when the product is critical and the contractor has an urgent financial need.

**a) *Avtex***

On October 31, 1988, Avtex announced it would cease operations and shut down its Front Royal, Virginia facility due to (among other things) "mounting environmental and safety concerns."<sup>356</sup> Although Avtex was a sixth tier subcontractor with DoD and NASA, it was the only qualified source of aerospace grade continuous filament rayon yarn. The yarn was essential to manufacture strategic and tactical missiles, rocket boosters, and the Space Shuttle.<sup>357</sup> With the entire space launch program and much of the defense missile program hanging in the balance, NASA and DoD officials met quickly with Avtex to arrange for Avtex to recommence production. Multi-million dollar cash "infusions" allowed Avtex to reopen in just six days.<sup>358</sup>

Typical avenues for relief under FAR Section 50.302 (such as amendment without consideration) were not available, because there was no contract between Avtex and the government. Therefore, the Air Force Contract Adjustment Board (AFCAB) approved the relief under its "residual powers."<sup>359</sup> The decision that the agreement and funding

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<sup>356</sup> Avtex Fibers Front Royal, Inc., AFCAB No. 262, 4 ECR Reporter ¶ 47, Dec. 18, 1988, 1988 WL 404950.

<sup>357</sup> *Id.*

<sup>358</sup> *Id.* Morton Thiokol, the prime contractor on NASA's launch contracts, gave an immediate advance of \$7 million to Avtex in support of pending launch contracts, NASA agreed to advance \$11 million, and DoD agreed to guarantee an additional \$20 million. NASA and DoD also agreed to jointly create an additional \$5 million contingency fund.

<sup>359</sup> The AFCAB decision contains an excellent summary of the forms of extraordinary relief available pursuant to Public Law 85-804 at Section II, Authority for Relief.

would facilitate the national defense depended upon the critical need for Avtex products. The board rested its decision on the following facts: Avtex was a unique source of aerospace yarn essential to the DoD space and missile program; there was an insufficient inventory of this product to meet current and projected needs; and, delays in production would cause severe operational and financial damages.<sup>360</sup>

*Avtex* teaches several 85-804 lessons. It is never too late to seek extraordinary relief. Contracts with the government are not necessary predicates to extraordinary relief. If a defense product is important enough, the government will find a way to secure it. *Avtex* also teaches an important environmental lesson. Costs of remediation can overwhelm a business—to the point of failure. Contractors would be well advised to seek relief *before* reaching this point.

**b) *National Defense Corporation***

In *National Defense Corporation* [hereinafter *NDC*], the Army entered into a settlement agreement to share costs to restore the environment at NDC's ammunition production facility in Eau Claire, Wisconsin.<sup>361</sup> During the Vietnam War, NDC had produced nearly 100 million explosive projectiles for the Army. Although NDC was no longer in active production, "the facility remains a critical component of the Army's mobilization base."

The board found in favor of NDC and endorsed the agreement "as an acceptable compromise of a complex, multifarious set of contractual and environmental problems."

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<sup>360</sup> *Id.* (12-18 month delay estimated to cost from \$100 million to \$500 million).

<sup>361</sup> National Defense Corp., ACAB No. 1231, 4 ECR Reporter ¶ 47, Mar. 25, 1988 GAO reported the amount of relief as \$5 million. GAO/NSIAD-95-27, *supra* note 316, at 2.

While the NDC facility was contractor owned and operated, it was distinguished from other such facilities because of prior government ownership of the site. Further, “the Army was guided in reaching this agreement by strong Congressional sentiment that the Army participate in restoration activities at Eau Claire in order to preserve the facility’s production capability.”<sup>362</sup> Finally, the board was concerned it might be scientifically impossible to sort out liability for the contamination under environmental law. The main principle to be derived from this case is that demand for a product need not be immediate, so long as the contractor’s production capacity is vital during wartime.

c) *Starmet*

The *Starmet* cases are ideal for examining the high threshold a contractor must meet to prove it is “essential to the national defense,” because the company received relief when it was found to be critical, but was later denied relief when no longer deemed essential. *Starmet* produced significant quantities of depleted uranium penetrators at its weapon manufacturing facility in Concord, Massachusetts.<sup>363</sup> Its metal processing operations generated radioactive and toxic wastes (including heavy metals) that were deposited in a permitted holding basin.<sup>364</sup> Due to increasingly stringent environmental laws, the Army and *Starmet* became concerned about cleaning up the holding basin.<sup>365</sup>

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<sup>362</sup> *Id.*

<sup>363</sup> Nuclear Metals, Inc., ACAB No. 1244, 4 ECR Reporter ¶ 83, Sept. 13, 1996, *as amended in*, Nuclear Metals, Inc., ACAB No. 1244A, 4 ECR Reporter ¶ 86, Mar. 5, 1997.

<sup>364</sup> *Id.* *Starmet* had obtained proper licenses and permits from the state.

<sup>365</sup> *Id.*

The Army agreed to pay for complete and proper disposal of new wastes generated under existing contracts, but could not agree with Starmet about how to pay for wastes produced under closed contracts.<sup>366</sup> The Nuclear Regulatory Commission demanded financial assurances that Starmet could meet escalating environmental liabilities, bringing this issue to a boil. (Starmet's operating license was on the line.)<sup>367</sup> Starmet needed immediate financial relief. Neither the Army nor Starmet could await environmental litigation to sort out their respective cleanup obligations.

At the same time, the demand for depleted uranium munitions dwindled and Starmet patented and began to produce a beryllium-aluminum product that was lighter and stronger than aluminum and better capable of being cast in complex shapes desirable for airborne weapons applications.<sup>368</sup> The latter unique capability to produce lightweight components for the Comanche helicopter drove the ACAB's unanimous decision that Starmet's "continued availability as a source of critical supplies, is essential to the national defense."<sup>369</sup> The ACAB also stated, "It is the future viability of an essential defense contractor that FAR 50.302-1(a) seeks to protect, not merely the prevention of the loss to an essential contractor under a single contract."<sup>370</sup>

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<sup>366</sup> *Id.*

<sup>367</sup> *Id.*

<sup>368</sup> *Id.*

<sup>369</sup> *Id.* The determinative rationale is explained at n.9 (status as essential supplier for the Comanche helicopter program made resolution of essentiality to other defense programs unnecessary).

<sup>370</sup> *Id.* Only one depleted uranium contract (estimated to account for 2.7 percent of the waste) remained active. Costs to clean up the entire site could not be allocated to the one

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Unfortunately for Starmet, its future was not so bright. It miscalculated the nature and extent of contamination. The \$6,525,979 relief granted by the ACAB proved insufficient. Starmet filed another request for ECR—this time asking for an additional \$17,613,106.<sup>371</sup> Although only a few years had passed, the Army deemed Starmet no longer essential. Starmet responded that it was essential to the M1A2 tank, Comanche helicopter, and Joint Strike Fighter programs. The ACAB found “evidence of essentiality was not persuasive” and noted that, “the Program Manager for Comanche has determined that Starmet is no longer an essential supplier of critical parts of this program.”<sup>372</sup> No further discussion of essentiality was provided.<sup>373</sup>

While agencies certainly can and must determine whether contractors are essential to national defense, this case illustrates just how precarious such status can be. Mission requirements or agency or congressional priorities could change overnight. Competitors may develop the capability to produce a critical item, reducing the government’s dependence on the original contractor. Current policies to protect second sources, promote socioeconomic programs,<sup>374</sup> or promote competition may not justify extraordinary relief.

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open contract, nor could this contract support the essentiality determination for ECR because of the decreasing need for these munitions.

<sup>371</sup> Starmet, ACAB No. 1248, 4 ECR Reporter ¶ 92, Dec. 4, 2000.

<sup>372</sup> *Id.*

<sup>373</sup> *Id.* The Army may have found another supplier for Comanche parts since a Starmet competitor is mentioned in another context in the opinion. Starmet’s claims to be essential to other programs were not even discussed.

<sup>374</sup> Starmet was a small business. Nuclear Metals, ACAB No. 1244, *supra* note 363.

Contractors should secure adequate relief while they are critical and should be mindful that costs for remediation may far exceed estimates.<sup>375</sup> A contractor that is no longer “essential” may request ECR from the government in the interest of “fairness.” However, contractors have never recovered environmental costs on this basis.

## 2. Fairness

“[W]hen Government action, while not creating any liability on the Government’s part, increases performance cost and results in a loss to the contractor, fairness may make some adjustment appropriate.”<sup>376</sup> FAR 50.302-1(b) allows amendment without consideration in such circumstances when the government “directs its action primarily at the contractor and acts in its capacity as the other contracting party.”<sup>377</sup> Generally it is the character of the act as a contractual act versus a sovereign act that will “determine whether any adjustment in the contract will be made.”<sup>378</sup> The following sections discuss the differences between sovereign and contractual acts, the sanctity of sovereign acts absent an unmistakable contract term obligating the government to refrain

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<sup>375</sup> A cost-based remedy would have allowed the government to bear this cost-escalation risk. The ACAB considered Starmet’s rejection of an Army cost-reimbursement proposal when denying Starmet’s ECR argument based on fairness (discussed in the next section).

<sup>376</sup> FAR 50.302-1(b).

<sup>377</sup> “The language of this regulation, setting out the criteria for relief, is critical. It states that when the government directs its action primarily at the contractor, a contract may be adjusted in the interest of fairness.” *Application of Automated Power Systems, Inc. For Extraordinary Relief Under 50 U.S.C. § 1431 et seq.*, Docket No. 85-804-16, 4 ECR ¶ 57, June 24, 1991.

<sup>378</sup> *Id.* But see, *Martin Marietta Team*, ACAB No. 1243, Feb. 28, 1995, 1995 WL 465141 (loss resulting from either a contractual or sovereign act could be considered).



from acting in a particular manner, and how environmental liability stems from sovereign versus contractual acts.

**a) Contractual versus Sovereign Acts**

The general rule is that “when the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.”<sup>379</sup> The general rule is tempered by the existence of sovereign power. In other words, “every contract is presumed not to interfere with the sovereign power of the United States to legislate.”<sup>380</sup>

Government actions as a contractor must be distinguished from its actions as sovereign, because the United States has no contractual liability for its sovereign acts.”<sup>381</sup> Sovereign acts are “public and general.”<sup>382</sup> A sovereign act may impact a contract as long as the impact is merely incidental to the broader government objective.<sup>383</sup> An act of government is not public and general if it has the “substantial effect of releasing the Government from its contractual obligations.”<sup>384</sup> The unmistakability doctrine allows

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<sup>379</sup> *Kimberly Assocs. v. United States*, 261 F.3d 864, 868 (9th Cir. 2001) (quoting *Lynch v. United States*, 292 U.S. 571, 579 (1934)).

<sup>380</sup> *United States v. Winstar Corp.*, 518 U.S. 839, 872, (1996) (plurality opinion of Souter, J.) [hereinafter *Winstar*].

<sup>381</sup> *Id.* at 518 U.S. 892 (quoting *Horowitz v. United States*, 267 U.S. 458, 461 (1925)).

<sup>382</sup> *Id.* at 518 U.S. 895-96.

<sup>383</sup> See *Precision Pine & Timber, Inc. v. United States*, 50 Fed. Cl. 35 (2001) (quoting *Winstar*, *supra* note 380, at 898).

<sup>384</sup> *Winstar*, *supra* note 380, at 899.

the government to make contractual promises that bind future Congresses.<sup>385</sup> However, its sovereign power, “will remain intact unless surrendered in unmistakable terms.”<sup>386</sup>

These considerations are discussed next.

#### **b) The Relationship Between the Sovereign Acts and Unmistakability Doctrines**

The U.S. Supreme Court struggled with the interplay between the sovereign acts and unmistakability doctrines in *United States v. Winstar*<sup>387</sup> While the weak plurality and many splintered opinions offered tremendous fodder for law review articles,<sup>388</sup> the Supreme Court confused more than clarified this interplay. The U.S. Court of Appeals for the Federal Circuit has since applied *Winstar*. In *Yankee Atomic Elec. Co. v. United States* the Federal Circuit analyzed whether the legislation at issue was a sovereign act, and then decided whether earlier contracts contained unmistakable promises not to act in this manner.<sup>389</sup> The court did not discuss the hierarchy or interplay between the two

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<sup>385</sup> *Yankee Atomic Elec. Co. v. United States*, 112 F.3d 1569, 1578 (Fed. Cir. 1997), *cert. denied*, 524 U.S. 951 (1998) [hereinafter *Yankee Atomic*].

<sup>386</sup> *Winstar*, *supra* note 380, at 899. “In cases where the unmistakability doctrine applies, it is demanding: it holds that for the United States to waive its sovereign rights when entering into a contract with a private citizen, it must do so in unmistakable terms.” *Grass Valley Terrace v. United States*, 51 Fed. Cl. 436 (2002).

<sup>387</sup> *Winstar*, *supra* note 380.

<sup>388</sup> A LEXIS search of the Combined Law Review database on May 31, 2002 disclosed 192 articles that mention *Winstar*. See e.g., John Cibinic, Jr., *Symposium: When Does Retroactivity Cross The Line?: Winstar, Eastern Enterprises And Beyond: Retroactive Legislation And Regulations And Federal Government Contracts*, 51 ALA. L. REV. 963 (2000); Joshua I. Schwartz, *The Status of the Sovereign Acts and Unmistakability Doctrines in the Wake of Winstar: An Interim Report*, 51 ALA. L. REV. 1177 (2000).

<sup>389</sup> *Id.*

doctrines, but instead concluded that the outcome would be the same regardless of which Supreme Court Justice's methodology from *Winstar* was applied.

The U.S. Court of Federal Claims addressed this interplay head-on in *General Dynamics v. United States* [hereinafter *General Dynamics*].<sup>390</sup> *General Dynamics* contains an extensive discussion of the relation between the sovereign act doctrine and unmistakability. Essentially, Senior Judge Lydon concluded that a court should first determine whether the legislation was a sovereign act.<sup>391</sup> If not, then the facts must be analyzed to determine whether the government is bound according to ordinary principles of contract law.<sup>392</sup> But, if a court concludes that the legislation was a sovereign act, then it must determine whether the government made an unmistakable promise to be bound in contract despite subsequent legislative change.<sup>393</sup>

**c) Application of Sovereign Acts and Unmistakability to Environmental Liability**

RCRA and CERCLA impose cleanup liability “publicly and generally.” Restoring the environment protects public health and reduces risks to the environment from toxic releases. Any resulting impacts on government contracts are merely incidental to the accomplishment of these broader societal objectives. Neither RCRA nor CERCLA has the substantial effect of releasing the Government from its contractual obligations. Further, government contracts contain no unmistakable promises that Congress will not tighten environmental laws in the future. Finally, both statutes create

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<sup>390</sup> *General Dynamics v. United States*, 47 Fed. Cl. 514 (2000).

<sup>391</sup> *Id.* at 541 (following *Yankee Atomic*, *supra* note 385).

<sup>392</sup> *Id.*

<sup>393</sup> *Id.*

liability for the government to bear or share costs of cleanup under specified circumstances (*see* Section III.B. *supra*).<sup>394</sup> Therefore, liability under RCRA or CERCLA stems from sovereign versus contractual acts.

Nevertheless, actions of the government as a contractual partner may have caused or contributed to the pollution (such as design of the waste disposal system). In such circumstances, it is appropriate to consider whether ECR is appropriate in the interest of fairness when the government later changes the laws.

*Starmet* is the only ECR case considering recovery of cleanup costs under FAR 50.302-1(b). The ACAB considered and rejected *Starmet*'s argument that fairness mandated relief from the Army for mounting environmental cleanup costs—even though government contracts generated the vast majority of the pollution.<sup>395</sup>

The *Starmet* Board indicated that to receive such relief the requestor must “generally meet three elements: (1) the contractor suffers an actual loss under a defense contract; (2) the government action cited caused that loss; and (3) the government action resulted in unfairness to the contractor.”<sup>396</sup>

The board found *Starmet* failed to demonstrate the necessary loss to prove the first element, because it was trying to ascribe all of its environmental costs to the single lingering depleted uranium contract, which had only accounted for 2.7 percent of the

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<sup>394</sup> “[W]hen Government action, while *not creating any liability on the Government’s part*, increases performance cost and results in a loss to the contractor, fairness may make some adjustment appropriate.” FAR 50.302-1(b) (emphasis added).

<sup>395</sup> *Starmet*, *supra* note 371, at 6. *Starmet* alleged 96 percent of damages were from government contracts.

<sup>396</sup> *Id* at 4.

pollution. Instead, to accurately reflect whether Starmet was in a loss position, it should have, but failed to, “allocate the remediation costs across the full spectrum of contracts that contributed to the contamination of the holding basin, and then compare the profits to the environmental remediation costs.”<sup>397</sup> Unless or until Starmet could prove all its historic profits had been eviscerated by the cleanup costs, it could not obtain this relief.

The board next considered the second and third elements: “Even if Starmet were to have sustained losses, . . . Starmet failed to persuade the ACAB that government action unfairly caused the company to sustain those losses.”<sup>398</sup> Merely entering into contracts that involved processing and disposal of hazardous substances “were not the type of government actions that Pub. L. 85-804 relief was designed to address.”<sup>399</sup> The board reasoned the purpose of ECR is to promote national defense, not to bail out every contractor who sustained a loss on a contract involving hazardous waste. “Thus, the mere fact that the Government provided a hazardous material to the contractor that resulted in hazardous waste does not equate to government action that unfairly caused the contractor to incur losses on a contract.”<sup>400</sup>

An additional factor that undercut Starmet's fairness argument was that the Army offered Starmet the opportunity to remediate its holding basin and charge over 70 percent of the costs as overhead. Starmet instead chose to keep its overhead down to attract more business and generate greater profits. Had Starmet accepted the Army's offer, the

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<sup>397</sup> *Id.* at 5.

<sup>398</sup> *Id.*

<sup>399</sup> *Id.*

<sup>400</sup> *Id.*

holding basin would have been cleaned earlier and largely at government-expense. For similar reasons Starmet's ECR request based on the ACAB's residual powers<sup>401</sup> was denied. Although broad, residual powers do not "provide an unlimited source of Government largesse."<sup>402</sup>

Finally, the board denied the residual powers relief to avoid a continued piecemeal approach to this situation. With the Starmet site being added to the National Priority List, EPA would become involved in the process and could better ensure the Army did not bear a disproportionately large share of the cleanup costs.<sup>403</sup> "Other avenues [i.e. CERCLA contribution] exist to achieve a comprehensive and fair resolution of Starmet's environmental problems at its Concord facility." However, when it looks like the United States is the only other PRP for contamination, an approach that allows cost sharing with the contractor is preferable to an approach where the contractor goes out of business. This observation is discussed more fully below.

### **3. ECR Observations and Recommendations**

To summarize, whether a contractor is "essential" under the FAR depends upon the contractor's financial circumstances and how uniquely important they are to the national defense. Nothing, however, in the statute or the executive order commands such

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<sup>401</sup> "Residual powers" includes all authority under Public Law 85-804 not covered in FAR Subpart 50.3 or the authority to make advance payments. FAR 50.400.

<sup>402</sup> Starmet, *supra* note 371, at 6.

<sup>403</sup> *Id.* at 7. The ACAB noted other PRPs included, "the Departments of Energy, Treasury, Air Force, Navy, and Army, as well as Olin Corporation, Honeywell Corporation, and Starmet itself."

a restrictive approach.<sup>404</sup> Because the FAR fails to define “essential to the national defense,” CABs decide each case on its own merits. To a certain extent, each case must be decided individually, because each contractor’s contribution to the national defense is unique. However, there is no policy guidance to aid the CABs in their determination of essentiality; they simply must “know it when they see it.”<sup>405</sup>

The FAR council should define “essentiality” to clearly encompass second sources. Second sources provide valuable redundancy. As in Bioport, the government may not be able to quickly replace contractors when there is no second source available.<sup>406</sup> Short of a new executive order or FAR change, the CABs could exercise their residual powers to afford this relief. Ultimately, putting valuable contractors out of business weakens, rather than strengthens, our war-fighting posture.

Defining “essential” to include second sources of vital military items could prevent bankrupting contractors who are and have been producing useful defense products for decades simply because a competitor can now supply key military products. Also, affording relief before contractors have reached the brink of bankruptcy may prove more cost effective. The government should address problems early before costs escalate. Using Starmet as an example, if the Army would have insisted on a cost-based bail out, or performed the remediation itself, it could have assured adequate resources

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<sup>404</sup> “The description in FAR 50.302-1(a) of when relief to a contractor deemed essential to the national defense may be appropriate is more narrowly defined than is required by Public Law 85-804.” *Id.*

<sup>405</sup> *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart J. concurring) (describing the now famous test for illegal pornography).

<sup>406</sup> *Bioport*, *supra* note 353. A redundant supplier of anthrax vaccine would certainly facilitate the national defense.

were quickly devoted to the cleanup. It could have also required a long-term pay back from Starmet over the course of future contracts (as the Air Force and NASA had done in the *Avtex* case).<sup>407</sup> A solid prospect for recovery may also help convince the CABs that salvaging an important contractor for mobilization purposes is essential to national defense (as was done in *NDC*).<sup>408</sup>

The FAR approach also utterly disregards the underlying circumstances that prompted the contractor to seek extraordinary relief. While equitable ECR is available to mitigate these harsh consequences, the FAR provides an even less reliable barometer for measuring "fairness."<sup>409</sup> "Residual Powers" under Public Law 85-804 allow the CABs to go beyond the FAR to fashion any appropriate relief to facilitate the national defense. These broader principles should be embraced when the government will ultimately be liable for environmental costs. Where owner, operator, or arranger liability attaches to the government for the pollution at the site, the CABs should look at the big picture. It might be cheaper in the long run to keep the contractor afloat so it can continue to produce critical items (which could be stockpiled as in *Avtex*).<sup>410</sup> Meanwhile, the contractor should contribute to the cleanup, something a bankrupt contractor cannot do.

Whether the contractor makes commercial products or defense products, the polluter pays principle ordinarily should apply. However, the contractor should not be left holding the bag for environmental liability arising predominantly or completely from

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<sup>407</sup> *Avtex*, *supra* note 356.

<sup>408</sup> *NDC*, *supra* note 361.

<sup>409</sup> FAR 50.302-1(b).

<sup>410</sup> *Avtex*, *supra* note 356.



performance of government contracts. "Residual powers" relief from CABs could allow contractors to escape the draconian fairness rubric of FAR 50.302-1(b). This could happen in the toxic tort scenario, but only under unusual circumstances.

Where the government controls the disposal/pollution generating activities, the contractor should be protected by the government contractor defense.<sup>411</sup> If the defense fails, the government as the polluter should pay its fair share of the liability.<sup>412</sup> The courts acknowledge as much by waiving the government's independent contractor defense for tort liability when the government controls the detailed daily physical performance of the work.<sup>413</sup> Residual powers could allow such equitable relief.

In contrasts, when the contractor controls the decision to pollute and the means and mechanisms causing the pollution, extraordinary relief would be inappropriate. "Even when the United States imposes specific conditions on the contractor to implement federal objectives and takes action to compel compliance with federal standards, it is not liable."<sup>414</sup> Applying the ACAB's logic from *Starmet*, "the mere fact that the Government provided a hazardous material to the contractor that resulted in hazardous waste does not equate to government action."<sup>415</sup> Rather, this is a buyer-seller relationship; the

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<sup>411</sup> The U.S. Federal Circuit Court of Appeals drew the same conclusion in the Agent Orange litigation since the government had demanded production of this toxin in accordance with detailed specifications. *Hercules, Inc. v. United States*, 24 F.3d 88 (Fed. Cir. 1994), *aff'd on other grounds*, 516 U.S. 417, 421-422 (1996).

<sup>412</sup> As explained in Section III.B.(2)(b)(2), the discretionary function exception may nevertheless allow the government to escape tort liability.

<sup>413</sup> Orleans, *supra* note 168, at 815.

<sup>414</sup> *Id.*

<sup>415</sup> *Starmet*, *supra* note 371.

government is the customer that the contractor looks to as a source of business and profit.<sup>416</sup> Forcing contractors to absorb and internalize the costs of pollution will motivate more environmentally friendly practices.

To grant relief under these circumstances would also undermine congressional intent in CERCLA that the polluter pays and in the FTCA that the Government should not be held vicariously liable for the acts of its contractors. The CERCLA regime contemplates that when the government is a responsible party it should pay its fair share. The contractor should not escape its responsibility to the environment simply because it does business with the government versus the public.<sup>417</sup> The FTCA shields the government from tort liability unless it controlled the day-to-day activities of the contractor. The spirit and intent of these two major statutes should not be lightly ignored.

## **VII. Conclusion**

Consistent with the historic purpose of this emergency wartime legislation, Public Law 85-804 indemnification is appropriate only in rare cases. 85-804 should not be used to escape the ordinary "polluter pays" principle of CERCLA. Protection must be reserved for truly "unusually hazardous" or nuclear risks. Until Congress acts to more specifically define these risks or develop a comprehensive national indemnification scheme, agencies must continue to decide contractor requests on a case-by-case basis. Inconsistencies will remain and indemnification for the cost of cleaning up hazardous or radioactive waste will continue to be inappropriate.

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<sup>416</sup> Shell Oil, *supra* note 110.

<sup>417</sup> While there is some truth to the argument that costs borne by the contractor will be passed to the government as its customer, the prospect of liability serves as a motivator not to pollute in the first place.

Indemnification is not warranted to insulate a government contractor from the *ordinary* costs of its own pollution. "The remedy that Congress felt it needed in CERCLA is sweeping: *everyone* who is potentially responsible for hazardous-waste contamination may be forced to contribute to the costs of cleanup."<sup>418</sup> Federal contractors should not be coddled and protected from such costs while the rest of American industry pays its fair share for its own historic pollution.<sup>419</sup>

On the other hand, broader relief for environmental liability should be sought under 85-804's contract adjustment board process. The definition of when a contractor is essential to the national defense should be expanded and clarified by the FAR Council or the President to promote uniformity among agencies. In the meantime, agency contract adjustment boards should look beyond the confines of the FAR to the broader "residual powers" to protect the best interests of our country. Extraordinary contractual relief should continue in those unusual circumstances where America will lose a vital defense contractor without emergency financial relief. In such circumstances, the notion that the polluter pays is secondary to the concept that America will "pay any price, bear any burden"<sup>420</sup> to ensure the defense of this great nation. This presidential philosophy

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<sup>418</sup> *Pennsylvania v. Union Gas*, 491 U.S. 1, 21 (1989) (plurality opinion of Brennan, J.).

<sup>419</sup> "Congress and the pentagon insulate the defense industry from the normal rough-and-tumble risks of doing business . . . . The nation's defense giants are coddled in ways only dreamed about by most commercial companies." Rick Atkinson & Fred Hiatt, *Contracting Conducted Over Golden Safety Net*, WASH. POST, Mar. 31, 1985 at A1. Atkinson and Hiatt further note Public Law 85-804 had been used more than 6,000 times to "bestow \$1.4 billion on troubled contractors."

<sup>420</sup> President John F. Kennedy, Jr., Inaugural Address, Jan. 20, 1961, *as reported by* James P. Pinkerton, *Bush Must Sell His Doctrines to the World*, NEWSDAY, Feb. 7, 2002, at A41.

continues to ring true today, “while the price of freedom and security is high, it is never too high.”<sup>421</sup>

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<sup>421</sup> President George W. Bush, State of the Union, *supra* note 1.

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